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LOCAL TELEPHONE RATES

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

LOCAL TELEPHONE RATES

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LOCAL TELEPHONE RATES

MONDAY, AUGUST 29, 1983

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION,
Vancouver, Wash.

The committee met, pursuant to notice, at 9 a.m., in the community room, Clark County Public Utilities Building, 1200 Fort Vancouver Way, Vancouver, Wash., Hon. Slade Gorton presiding.

Staff members assigned to this hearing: Ward H. White, senior counsel and Thomas W. Cohen, minority staff counsel.

OPENING STATEMENT BY SENATOR GORTON

Senator GORTON. It is 9 o'clock. We have a large number of witnesses to hear, and I would appreciate guests and witnesses taking their seats.

Welcome to this hearing of the Senate Commerce Committee on local telephone rates. All of us are aware of predictions of sharply higher rates for local telephone service. The purpose of this hearing is to look at the reasons for these predictions, at how they will affect the citizens of the State of Washington, and at whether there is a need for Federal legislation on the subject.

Here in the Vancouver area, according to data from the Washington Utilities and Transportation Commission, basic telephone rates for service from General Telephone Co. will rise from $12.36 today to at least $15.69 next year, and $21.29 by 1989, assuming no Federal legislation. The basic rate for the Lewis River Telephone Co. will rise from $5 today to $9.62 next year, and to at least $18.41 by 1989. For Pacific Telecom, the basic rate will rise from $6.10 now to $9.75 next year and $15.97 in 1989.

The reasons for these increases are complex. Many elements are within the jurisdiction of the Washington State Utilities and Transportation Commission, which has done a commendable job of working to keep local rates reasonable.

Two of the reasons for substantial increases, however, are Federal policy changes in the areas of equipment depreciation and access charges. There are now at least 13 bills before the Congress of the United States, most of which reverse the Federal Communications Commission's [FCC] access charge decision and attempt to maintain the system of support for local rates, which has been provided by long distance service in the past.

It has been the longstanding and highly successful policy of the Congress to promote universal, affordable telephone service. The FCC decisions are an abrogation of that policy if these decisions cause people to go without telephone service. It is clear that long-

distance service must pay part of the cost of maintaining the local telephone system if we are to have universal service. The FCC recognized this and created its Universal Service Fund, the money for which comes from long-distance revenues. This fund is expected to be approximately $500 million per year, or about 5 percent of the present $10 billion in joint costs that are covered by long-distance revenue.

Between these two extremes, there should be an appropriate level which balances the sometimes conflicting goals of providing affordable telephone service, eliminating incentives for bypass, encouraging new technologies, and promoting a more competitive marketplace.

The difficult job of balancing these goals is nowhere better illustrated than here in Washington. Our State is substantially rural, with rugged terrain and low population density in a number of areas. This makes the cost of telephone service to those areas high. At the same time, Washington has major urban areas, which are the business centers for much of the Northwest and the inland empire. We have a rapidly growing computer industry, and we enjoy the benefits of an increasing number of new communications technologies. Witnesses today will represent these varied interests, and I look forward to the testimony of each of them.

We are extremely pleased to have as our first two witnesses the Honorable Al Williams, chairman, and the Honorable Seth Armstrong, vice chairman of the Joint Select Committee on Telecommunications of the Washington State Legislature.

We will ask the two of you to come forward at this point, and because of the number of witnesses here today, we hope that each of you will attempt to limit your formal testimony to about 5 minutes. To the extent that you have submitted written testimony, it will be included in the record as if it had been read in full.

And with that, Al, we will start with you.

STATEMENTS OF AL WILLIAMS, CHAIRMAN, JOINT SELECT COMMITTEE ON TELECOMMUNICATIONS, WASHINGTON STATE LEGISLATURE, OLYMPIA, WASH.; AND SETH ARMSTRONG, VICE CHAIRMAN, ACCOMPANIED BY SHARON NELSON, STAFF DIRECTOR

Senator WILLIAMS. Thank you very much, Senator. I am pleased to be here, and I appreciate the invitation to testify.

As you indicated, with me is Representative Seth Armstrong, the vice chairman of the committee, and also with us is Sharon Nelson, who is our staff director for that committee, recently started.

I would first like to indicate that our committee, the Joint Telecommunications Committee that we have created, is basically just getting up to speed. So the testimony that I will give today and I believe that Representative Armstrong will be giving is our testimony as members of the legislature, not representing the Telecommunications Committee or, for that matter, the legislature as a whole. So these are our comments.

I am just going to summarize the testimony that I presented to you and try to hit the main points of that testimony.

The changes in the telecommunications industry structure and regulation have not been characterized by unanimity among economic theorists or by direction by Congress. Consumers have not been adequately represented in the decisionmaking process. The FCC access charge decision and the Washington Utilities and Transportation Commission proposal could have significant detrimental effects on the ratepayers, especially those on low or fixed incomes, jeopardizing the universal service goal which has been the object of public policy for the last 50 years, as you indicated earlier.

Some respected economists have seriously questioned the assumption on which the access charge is based, that interstate services have subsidized local rates. If, as alleged by these economists, local rates are being used to subsidize competitive service offerings, approval of the FCC access charge decision could result in further economic distortion, not economic efficiency as is expected.

The impact on those fixed incomes could be severe. Elasticity studies done by AT&T indicate that there will be a substantial dropoff of the network by the poor, especially the black and rural users. Those without discretionary income may literally have to decide between phone service and other necessities of life.

The perceived threat of uneconomic bypass may be exaggerated. This exaggeration is crucial because it is the chief rationale for the FCC's decision to impose access charges on end users rather than on the interexchange carriers. We are also concerned about a potential transfer of wealth from the local monopoly ratepayer to the high volume, interstate, big business users and interchange carriers.

And finally, because the FCC access charge decision ignores the goal of universal service and may be based on faulty economic analysis, I endorse the legislative intent of S. 1660. The bill does have some technical corrections which we have offered also, but I believe that generally the status quo should be preserved pending further analysis by national and state policymakers.

Basically what we are saying is we support the change that is being suggested by this bill and any of the other bills in Congress, that the FCC ruling at present is contrary to the universal service policy, and that really, the basic way—and our UTC seems to be falling in line with that, and we would hope that Congress would act in some way on this.

Thank you.

[The statement follows:]

STATEMENT OF AL WILLIAMS, CHAIRMAN, JOINT SELECT COMMITTEE ON TELECOMMUNICATIONS, SENATOR, WASHINGTON STATE LEGISLATURE

Mr. Chairman, thank you for your invitation to testify at this hearing today on S. 1660. The concerns that prompted this hearing are very much shared by many in this state. It was these concerns that led our State Legislature to establish a Joint Select Committee on Telecommunications to study the rapidly approaching changes in industry structure and possible resulting impacts on Washington State ratepayers. The Legislature also instructed this Committee to report to it whether any mitigation of adverse effects is needed. The Committee has just organized and will begin its formal inquiry in September. Consequently, I am here today speaking in my own personal capacity and the views expressed are my own and not those of the Joint Select Committee on Telecommunications.

The telecommunications industry is in the midst of unparalleled change. Changes in telecommunications technologies and regulatory philosophy have undermined the

traditional notions of the industry as a regulated monopoly. Unfortunately, changes in industry structure and national policy and regulation occurred with very little public attention or awareness until substantial rate increases recently attracted the attention of the press and the public. And, unlike the deregulation of parts of the transportation industry, telecommunications industry deregulation has proceeded so far with very little unanimity by experts on the paths that should be followed and without meaningful policy direction from Congress. The divestiture of the operating companies from AT&T was proposed by the Administration together with AT&T and approved by a federal judge. The FCC recently proposed by rulemaking an access charge that appears to have the effect of reversing 50 years of federal policy promoting universal service. Contrary to the legislatively mandated deregulation of the airline and trucking industries where Congress concerned itself with the preservation of service to small communities, access to the telephone network through maintenance of a policy of universal service in telecommunicaitons is strikingly absent. The concern the FCC has exhibited about the universal service goal is not by way of congressional direction.

Our constituents, who are facing the prospect of substantial escalating electric rate increases, are very concerned about the proposed rate increases in the telephone industry. Economic theory normally teaches that deregulation and competition are supposed to result in lower prices, innovation, and wider availability of consumer choice. Yet in the telecommunications industry, where competition is supposed to be increasing and new technology is being introduced, it appears that costs and prices of local service will increase substantially in the next few years. The reasons usually advanced to explain this apparent contradiction are: (1) that an alleged subsidy of local service has been provided by interstate sercice; (2) this subsidy will have to be eliminated because of the new industry structure; and (3) a proposed access charge, reflecting this new economic reality, will promote economic efficiency. Also contributing to increased rates are substantial increases in depreciation expenses which have been proposed by the various local operating companies on the theory they are needed because of rapidly changing technology, expanded competition and the costs of modernizing local facilities so they will be able to handle the new data transmission services and other information services.

The FCC itself noted that it had reversed its long standing assumption about the charges it would impose to allocate responsibility for nontraffic sensitive costs. This sudden reversal in policy surprised Judge Harold Greene who presides over the AT&T antitrust trial. The Judge noted: "The court was advised prior to the entry of the decree that whatever subsidy from long distance rates in the past have been inherent in local rate structure could and would be preserved by means of access charges levied on interchange carriers. However, in December of last year the FCC decided to levy such charges also on individual subscribers. This access charge decision undermines one of the assumptions underlying the court's approval of the decree—that there would be no impairment of the principle of universal service—that is, that everyone, regardless of income, would have access at least to a minimum of telephone service, in recognition of the fact that this service is a necessity rather than luxury. The FCC's decision unnecessarily jeopardizes this objective." *U.S.* v. *AT&T*, July 8, 1983, opinion at 74-75.

Much of Judge Greene's views on the hoped-for effect of deregulation should also be of concern to your committee: Evolving technology and deregulation should be expected to result in overall reduced costs. Rather than serve as a basis for imposing a new burden on local ratepayers, such technology and such reduced costs would be better be channeled to benefit all segments of the public, including the local subscribers. This is the crux of the public policy decision before you.

One of the most difficult issues posed is how to best promote economic efficiency at the same time as preserving the goal of providing universal service. Some economists such as William H. Melody, Richard Gable, Walter Bolter, Harry J. Trebbing believe that this is really not a dilemma at all because subsidies as alleged, in their view, do not in fact exist. The views of these economists, if accepted mean that the true dilemma for public policy is to make sure local telephone operating companies do not use monopoly ratepayer revenues to effect improvements not properly chargeable to local exchange users. Their view is that improvements like digitization benefit the long distance, high volume, business and information services user and not the local ratepayer who uses the phone for plain old telephone service. At this stage in the process, the dilemma for State Legislatures and the Congress is whether to act at all, and if so, how. It is alleged that corporate planning departments (users and providers) need certainty so they can make their business investments. The FCC access charge decision has been rendered by that agency and it is

assumed by most telecommunications experts that its access charge procedures will work at least technically.

Unfortunately, there is also substantial evidence that there will be a dramatic impact on our constitutents. The impact on the elderly and those on fixed incomes may be especially severe. A national study suggests that almost 30 percent of the elderly live at 125 percent of the poverty level, or $506 for a single person and $681 for a two-person family. A 1978 Washington State study supports this figure. Given an elderly population in Washington State today of some 600,000 people, this means the number of elderly poor and "near poor" is between 120,000 and 180,000 people. A Department of Social and Health Services Division of Income Assistance study using 1980 census data assumes a poor population in Washington State of 395,000 people or almost 10 percent of the population. The standard of need in this state, using a market basket method for computation, is $856 a month for family of four, $465 a month for singel person. There is virtually no discretionary income included in the market basket calculation. The amount budgeted for telephone is $6.98 a month for 1984. This is a far cry from the approximately $20 a month access charge which is currently being discussed. The problem is highlighted even more when you consider this state pays only about 65 percent of the standard of need. For the family of four whose need is $856 a month, the State of Washington pays $544. The situation is not better for the senior citizens whose standard of need is about $465. Social Security pays $323.

Policy makers should be concerned about the elasticity of phone service demand. AT&T has conducted an elasticity study on the subject. It indicated a substantial dropoff of the network by the very poor, especially black and rural users. That study is attached to this testimony. Also attached are the projected increases in local rates which would result from the FCC and WUTC proposed access charges. Seniors in areas served by many of our independent phone companies may literally have to decide between phone service and heat or food.

One of the chief rationales given by the FCC in its Access Charge Decision was that it wished to prevent bypass of the public switched network. Of course, that decision did not consider regulatory control of bypassers. The FCC staff report on the potential of bypass indicated that bypassers are still in very embryonic form and the threat may be more imagined than real at this point. The report cited an unnamed commentator as follows: "None of the above services will have more than a de minimis impact upon a local telephone company distribution system. Reasons for this opinion are based on the views that (1) there are systems not as cost effective as the present wire distribution systems now in place, (2) there is insufficient radio spectrum allocated to permit an extensive penetration, (3) reliability would not be adequate, (4) security of communications would be impaired, and (5) unversality of service would be lost, i.e., no common telephone numbering plan, credit billing." See FCC Third Report and Order, CC Docket 78-72, at 210.

Mr. Chairman, it is the tentative conclusion of Vice Chairman Armstrong and myself that the FCC's access charge decision may result in the transfer of wealth from local exchange monopoly ratepayers to high volume interstate and big business users. While the decision appears to be premised on concepts of economic efficiency, it ignores or has not considered significant competing economic arguments that continued opportunities for cross subsidization will be maintained. The failure to consider these other views, if approved by Congress and the state, could result in further economic distortion.

The FCC access charge decision basically ignores the goal of universal service. This is one reason I endorse the legislative intent and concepts of S. 1660. I do, however, have questions about certain provisions of the bill. I have directed our Staff Coordinator to make sure our questions are submitted for the record.

I appreciate the opportunity to testify here today and hope to work with you in the coming months in formulating appropriate public policy in this critical area of our economy.

Senator GORTON. Representative Armstrong.

Mr. ARMSTRONG. Thank you. Thank you for inviting the chairman of the Joint Select Committee and myself to this hearing on S. 1660.

As the chairman has indicated, we are speaking for ourselves as individual legislators, and we are not representing the views of the committee as yet.

For your information, I also serve as chairman of the House Energy and Utility Committee's Subcommittee on Telephone Divestiture. During the last legislative session we conducted a series of hearings on many issues pertaining to the restructuring of the telecommunications industry. Those hearings determined that the impact of the proposed interstate and intrastate access charges on the Washington State ratepayer will be substantial. As the chairman indicated in his testimony, the impact on the elderly will be especially significant. The impact on middle class and new and small business will also be significant.

Studies completed by a Washington independent telephone association have examined the impact on local telephone companies operating in Washington State. The cost impact which may result from these changes was estimated to be from $18.92 per month to $47.76 per month for merely obtaining a dial tone. Local usage, interexchange usage and telephone equipment charges would all be added to that bill.

Obviously, the impacts on the residential ratepayer could vary widely depending on the service area in which he or she lives and the ultimate decisions of Congress, the FCC, our State legislature, and the Washington State Utilities and Transportation Commission.

The Washington State Independent Business Association estimates that the average small business ratepayer served by GTE would have an additional $37.20 added to his monthly bill as a result of proposed Federal and State access charges.

A number of elasticity studies have been performed to indicate what level of disconnection or dropoff might occur given certain rate increases for local telephone service. To date there has been no such study done for Washington State ratepayers. The study by Perl for AT&T indicated there will be substantial disconnects for the low-income and rural ratepayer. The FCC staff, in appendix G to its recent access charge proceeding, Common Carrier Docket 78–72, concluded that overall there may be a 10 percent dropoff of subscribers for each 100 percent increase in the rates. The Washington Utilities and Transportation Commission indicated that it may conduct an elasticity for this State. However, that study has not been released. Hence, its possible contribution to State and Federal decisionmakers is unknown.

As I am sure the chairman is aware, the ratepayers in Washington State are in no mood for another round of utility rate increases. My mail on this telephone issue is picking up substantially, and I am sure it will reach a floodtide come January 1984. As in the WPPSS debacle, that will be too late for consumers to start complaining. The public policy formulation with respect to this industry has been characterized by a complete lack of informed consumer input. This is deplorable.

In the deregulation of the transportaton industry, in contrast, including both the airlines and trucking, public policy formulation was assisted by considered opinion from various consumer groups. Also in transportation, academic and regulatory economists encouraged Congress to deregulate and let marketplace competition begin. Yet, concerns for certain sectors of the population were explicitly treated in legislation. For example, in truck deregulation, service

to small communities was examined. In the airline deregulation, Congress guaranteed that service to small communities would not be discontinued within a specified period of time.

In the telecommunications industry, in contrast, we have neither unanimity among the economic theorists, nor have we had any real participation by any representatives of the general ratepaying public. Instead, in December of last year, the FCC, responding to the consent decree approved by Judge Greene, promulgated its access charge decision which will have a significant impact on the rates that local ratepayers pay.

The rationale of the access charge decision was to allocate costs and therefore charges on end users, otherwise known as ratepayers, consumers, and voters, and not on interexchange or long distance carriers as had been anticipated by many in Congress, the FCC itself, and by Judge Greene. The rationale for this sudden change in policy direction was that the FCC began to fear the possibility of uneconomic bypass if the interexchange carriers were to continue to cover part of the nontraffic sensitive or common costs associated with local exchange planning.

The FCC professed to have the goal of universal service in mind and sought to prohibit the cycle of large business users dropping off the network in favor of bypass technologies, thereby forcing residential ratepayers to assume a larger and larger share of the cost burden.

At this point, this bypass threat seems more imagined than real. As noted by the FCC staff, technology used to bypass the public switched network has none of the advantages of the public switched network. Most of such bypass services are embryonic, and the companies which have attempted to provide bypass service have not found a market.

Economists who have examined this issue tend to agree that the cost causer should pay for the costs involved in providing service. The question is who is the chief cost causer, particularly with respect to local exchange plant, these common services. Recent research by a number of well-respected economists indicates the local telephone user is not the major cost causer. These studies show that major portions of local switching costs are due to investments designed to meet the requirements of toll or specialized, that is, digital data services, that the residential ratepayer does not use and does not want. The plant which would be required only for basic local voice service is much less costly. I refer you to the "Allocation of Telephone Exchange Plant Investment" paper I referred to in my text.

Under the current system of jurisdictional cost separations, a portion of local exchange facility costs is allocated to interstate toll service. The jurisdictional cost separations methodology is not a method for implementing a full allocaton of costs between inter and intrastate services or between local and toll services. Rather, it is an arbitrary service, and it is used only to allocate certain costs to the interstate jurisdiction. All residual costs are assumed to be intrastate. Rates for basic local service are not based upon an independent determination of local service costs. They are determined by the residual intrastate revenue requirement needs which, in turn, are the residual costs emanating from the jurisdictional cost

separations process. This is a very long way from cost causation and was never designed to allocate actual costs for investments between various divested local Bell System exchanges and the long distance providers.

The Bell System has claimed continually over the last decade, and longer, that its philosophy of allocating costs to Federal and State jurisdictions and residual costing under the basic service philosophy permit local rates to be held as low as possible and to be subsidized by other services such as long distance. This fundamental underpinning of much of what is before the committee today has been seriously brought into question by a number of studies which have concluded that residual basic monopoly services, namely, our local service, have been in fact subsidizing competitive and specialized services rather than the other way around.

For example, William H. Melody of Simon Frazer University has demonstrated that subsidy does not flow from interstate services to intrastate. Instead, his work and the work of others indicates that subsidy instead flows from monopoly service to competitive services. For instance, Melody cited the seven-way cost study ordered by the FCC in 1964 which showed that private line, telpak, and television services offered by AT&T were being subsidized by our local ratepayers.

Similarly, it has been reported that in State studies where service categories are sensitive to potential competition such as terminal equipment or private line, the State commissions have concluded that the Bell operating company's terminal equipment category was being subsidized by other services. In other words, credible examination by a variety of parties on the issue of subsidy between local and long distance services calls into serious question recent policy changes by the FCC.

If the FCC in the past permitted subsidization from monopoly to competitive services, now it is the State commissions who are being urged to adopt the FCC's prior policies and accept the transfer of costs from interstate to intrastate under the guise of progress and economic efficiency.

But economic efficiency is possible only if the costs and the cross-subsidy of and between these various services are better understood. Further, optimizing efficiency is only one of many possible public policy choices which could also validly incorporate other legitimate public goals like universal service.

So far, it appears that even our local commission is following the rationale of the FCC, and it may therefore approve an intrastate access charge which is the mirror image of the Federal access charge.

When asked in a recent public hearing to explain how these anticipated increases in telephone rates will affect the universal service goal, the assistant attorney general representing the UTC responded by saying that the universal service goal now includes the concept of access to national network for transmission of data and business long distance communications which are different in kind from uses residential subscribers make of their telephones, a charge put on the locals for services they will never use.

It is my view that the public service obligation is owed to the residential ratepayer and the small and new business user.

Our State regulatory agency reflects the dilemma of most States. They recognize that technological advances have driven the change in structure of the industry but have as yet been unable to really do anything meaningful to mitigate the impacts of the proposed Federal access charge on the residential ratepayer. Our State commission, like most others, has not been any more able than the FTC to analyze the rationale for these changes.

Our commission apparently is in the process of attempting to develop a proposal for a universal service fund which will benefit individual users. While this sensitivity to mitigating adverse impacts is commendable, if the fundamental rationale for the proposed access charge at the Federal and State levels is in fact economically flawed, the intrastate access charge rule may be unnecessary and may cause further economic distortion. If the studies of people like Melody, Richard Gable, and the others are accurate, then the effect of these regulatory decisions would be to force monopoly, that is, local ratepayers, to finance the competitive world. This could be a colossal mistake premised on unproven and not universally agreed to economic theory.

The access charge proposal may be needed for other reasons. Testimony of Walter Bolter, a noted telecommunications economist, before the Florida Public Service Commission, indicates Southern Bell believes the charge is necessary as part of an overall strategy to finance proposed accelerated recovery by the newly divested operating companies of all new and imbedded plant, including the depreciation reserve deficit, and to retain high-revenue customers whose communications needs will extend far beyond basic voice service. It would also enable rapid replacement of existing facilities in the local network which, quite probably, exceed the requirements for universal local service, and instead, would provide facilities to serve high-speed and other data communication needs.

I support concepts embodied in S. 1660 and believe that the Congress should attempt to preserve the status quo until appropriate cost-justified access charges can be imposed with full recognition of the economic impacts on our universal service goals and on the ability of certain ratepayer groups to pay these access charges. When these studies are done and the essential economics fully understood, then appropriate regulations should be put into place. To do so prior to knowing what the impact will be is arbitrary and capricious regulation. Even more bothersome, it is proposed in the absence of a consensus to fundamentally alter the goal of universal service which has been a historic public policy objective.

Thank you for your kind attention, and we will be happy to answer any questions you may have.

Senator GORTON. First, Mr. Armstrong, toward the beginning of your testimony, you referred to a Washington independent telephone study.

Can you tell us who prepared that, and can you provide a copy of it with your testimony for our files?

Mr. ARMSTRONG. We can provide you with a copy, and I do not at the moment recall who did that. We shall provide you with a copy.

Senator GORTON. We would appreciate that.

Is the thrust of your individual recommendations that Congress should pass a bill which restores to the maximum possible extent

the status quo in terms the distribution of the costs of providing service? Would you like to keep the system that was in existence up until very recently, just prior to the divestiture?

Mr. WILLIAMS. I think that would be until there is satisfactory knowledge and evidence to the contrary or which points a way to a different direction in terms of assessing rates and so forth. And that is what we are questioning, as to whether the adequate knowledge is there at this time to properly judge the situation. Until that occurs, I think yes, what we are saying is preserve the status quo until adequate information to the satisfaction of consumers and all is there that shows that there is justification for a change.

Mr. ARMSTRONG. It is my view that based on the studies that have been developed so far, that we will find we would like to ask the Congress to restructure deregulation as it is currently being handed down by the FCC. So the status quo maintenance is a stopgap as I currently perceive it.

Senator GORTON. Can you give me any indication as to what kind of restructuring you think you will favor?

Mr. ARMSTRONG. Yes. I think that based upon the studies, we will find that long distance has not been subsidizing local, and that we therefore ought to put less of the cost on the local ratepayer and more of the cost of these changes on the long distance user.

Senator GORTON. Now, the thrust of the testimony of each of you has been that you do not believe that the factual basis for the recent changes have been appropriate, particularly, the factual basis for access charges. That is to say, you do not believe that long distance has been paying more than its fair share of providing all services and local service less than its fair share.

The FCC has been studying that issue for at least 5 years. At best it is a question subject to considerable dispute, one of which I despair of universal agreement. If Congress proceeds from the premise that in fact long distance has been carrying a certain percentage of the costs of providing local service, there are three rather discrete groups who benefit from that premise. First, there would be the poor, those who will normally use a lifeline service, and perhaps those who would want more lifeline service than if costs were what they considered to be reasonable.

Second, there are presumably all or almost all rural users, the customers of small companies that have to provide considerably more line per customer than is the case in a city. Finally, to the extent that there has been a subsidy or a quasi-subsidy, there would be all local telephone users, no matter how much money they make.

In your view, if we start from this presumption, should we treat any of those groups differently? As you know, some of the bills before Congress would deal only with the urban poor. Some would deal primarily with the rural systems.. More, like S. 1660, would have an impact on every user.

Do you have any set of priorities as to how we should deal with these issues, assuming that we proceed from an assumption different from that which you have reached at this stage?

Mr. WILLIAMS. I think that my opinion on that would be that until these drastic rate changes appeared on the horizon, I think there was a general feeling that the rate structure was such that

there was universal service; everybody had access to basic telephone service.

I suspect that my attitude would be that if possible, the rates should have a relationship to the service one expects out of the system and, in fact, uses out of the system, and hopefully it would mean that there would continue to be a very basic rate affordable by everybody which would allow basic voice communication to whoever and wherever that communication was necessary to.

Senator GORTON. And you do not think the FCC's Universal Service Fund is adequate to that end?

Mr. WILLIAMS. Well, the present system they are setting up tends to be inequitable, I think, in terms of the advantages of use of the system. I think it penalizes the lower income or the minimum user of the system by charging them a disproportionate amount in relation to how much they use the system.

Senator GORTON. One other related question is that most of the bills with which we are dealing provide that funds will go to high-cost operations based on a formula, based on the national average service cost. Some of them, as in S. 1660, are to a certain extent graduated formulas.

Is it good public policy at any point to have a 100 percent payout, or a 100 percent subsidy for all costs that are a given percentage above the national average? Or will that remove any incentive on the part of some of the rural companies to provide for technological advances that will lower the cost of service?

Mr. ARMSTRONG. I do not feel there should be a 100 percent payout. I feel, in a[illegible]on, that we should have a minimal affordable service, and th[illegible]hould not be a large burden on the system as a whole.

I think that what we are proposing is a cost-conscious, cost-allocating approach here. What we are disputing is that the restructuring of the telecommunications industry right now is cost related. We think that the costs are not going to the chief cost causers.

I might add on the previous question that I think there is a fourth group which is seriously affected by this. The small and new business entities in this State have been particularly disadvantaged and denied the advantages of the new technology because of decisions made by the local UTC which prevent them from pooling for the benefit of paying one access charge for a group of them as opposed to each paying an access charge, and I believe that things like that might be addressed in the Federal legislation as well.

Senator GORTON. Finally, I have one last subject I would like the comments of each of you on. That is the relationship between the FCC and State utilities commissions.

Let's say—and there is a very real chance that this will happen—that Congress decides it will reverse the FCC's access charge decision and decide that long-distance carriers should continue to pay some of the joint costs of service. Should we leave the State utility commissions free to do what you have stated our utilities commission was going to do—provide access charges for intrastate calls? Or should the Federal Government limit the authority of State utility commissions in this field more than it does now?

Mr. ARMSTRONG. On the assumptions you have stated, we should leave the State utilities and transportation commission more free.

Senator GORTON. Thank you both very much for your testimony. It has been very helpful to us.

Mr. WILLIAMS. Thank you, Senator.

Mr. ARMSTRONG. Thank you.

Senator GORTON. Our next witnesses will be the Honorable Mary Hall, and the Honorable A. J. "Bud" Pardini, commissioner of the Washington Utilities and Transportation Commission, with assistant attorney general Douglas Owens.

STATEMENT OF MARY HALL, AND A. J. "BUD" PARDINI, COMMISSIONERS, WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, ACCOMPANIED BY DOUGLAS M. OWENS, ASSISTANT ATTORNEY GENERAL FOR THE STATE OF WASHINGTON

Senator GORTON. Again, we will include in the record your written testimony and the documents that accompany it, and we would appreciate a summary of what you intend to deliver to us now.

You may proceed.

Ms. HALL. Thank you very much. It is my pleasure to be here today.

I might start out by saying that I would be happy to provide our joint committee, which is kind of new on the block, with more updated information on the cost of an access charge proposal in this State. The figures which you heard were done by the Independent Telephone Co., at about the time we were talking about Pure 2 with no high-cost factor. Those figures have been substantially, in fact, done away with and replaced by figures that have been accomplished in this State probably before any other State.

Mr. Owens will be telling you about what we have been doing in the study of costs, in looking at the technological aspects of the access charge decision and what this State can do.

You are probably aware that we have been very active in challenging the FCC, and have been in court over certain things having to do with depreciation. We are also a party in the challenge to 78–72. However, it is my position at this time, and I speak, again, for myself and not for the entire Commission, that it is important that we proceed with implementation of a system, and we are, in fact, looking at one which has several aspects similar to that of the FCC, with specific aspects associated with it that will make it better for the citizens of our State.

I would like to answer your questions rather than go forward with my presentation. Basically I want to say this about your bill, and I have relatively strong feelings about it, and that is that preemption and delegation is inconsistent with the constitutional role of the States. The States are not the administrative departments of the FCC, and certainly not of any aspect of the Federal Government. In Judge Greene's court, two Chiefs of Common Carrier Bureau, the FCC, testified that AT&T was too big to regulate. I believe that Congress and all of us deceive ourselves if we believe that the FCC can effectively regulate 22 Bell operating companies, 15 interconnects, and a whole new group of long-distance carriers.

The WUTC declines, as long as I can work at it, to be a department of the FCC. We are closer to the people, we are closer to the costs.

[The statement follows:]

STATEMENT OF MARY D. HALL, COMMISSIONER, STATE OF WASHINGTON, FOR THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

The public policy intent of S. 1660 is to make available, so far as possible, to all people of the United States, rapid, efficient, nationwide and worldwide telcommunications services with adequate facilities at reasonable charges, for the purpose of providing universal basic telephone service to customers. However, the bill is more likely to produce expensive, inefficient telephone service to all, urban and rural, business and residential customers. The concept of telecommunications as construed in the legislation is archaic. Furthermore, the legislation will reduce the probability of being able to keep basic service available to the low income citizens of Washington because it takes from the state the authority it needs to carry out its reponsibility for control of telephone rates.

To begin, we need to recognize what we mean by universality of service. The 1934 concept of universal service is different from what we know today. In 1934, universal service was a goal to be reached which woud entail everyone having wires to the home, at the other end of which an operator would be able to provide assistance. Today, universal service means satisfying the needs of people to communicate in emergencies and to retain social contact if the people are isolated, which it meant in 1934, but it also means other things. In addition to the availability of "dial tone" which allows these needs to be met, universal service today also means access to the national network for the transmission of data, and business long distance communications which are different in kind from the uses residential subscribers make of their telephones.

Current and projected changes in local telephone rates are a reflection of changes in the technology which produces telephone service, and in the reaction of the pricing mechanism to that technology. The perception of increased local telephone rates is a manifestation of a shift in the pricing of telephone service which removes part of the burden of paying for the "local loop" from users of long distance service, and places it on each subscriber to "dial tone."

The reason for this shift is that technological advances have made it possible for industry and small business to reduce their cost of doing business by using alternatives to the national switched telephone system for long distance. The incentive for business customers to do this is their perception that their rates for long distance are higher than necessary, in order that other customers' rates may be kept lower. The incentive has created a new corps of telecommunications providers who systematically undercut the prices charged business customers by the telephone companies.

Another impact of technological change is the need to replace the old equipment with the new. Typically, telephone equipment is estimated to have a long useful life. The depreciation which is figured into the telephone rate is based on this estimate. When technology changes sooner than expected, there is undepreciated equipment which must be written off in order to make way for the new investment. This write-off results in perceived increases in telephone rates. Such a change occurred within the last two years, as older, but not fully depreciated mechanical type switches were replaced by switches which use computers to perform their functions. Such a change results in requirements for increased rates to consumers.

Telephone service is an important element in the cost of doing business for the productive sector of the economy, which is industry and small business. As the cost of doing business for this sector rises, the excess social goods, or profits, which are available for distribution to other sectors of the economy, decline. Unless industry and small business are able to produce sufficient excess social goods, or profits, there will be nothing available to support our valued and needy elderly.

If all end users including the elderly are shielded from their share of the costs of dial tone and instead we burden the industrial and small business users of the system, the ability of the industrial and small business users to produce the excess social goods necessary to support the elderly is impaired. We have historical examples of inappropiate public policy responses to the emergence of new technology in a field of social significance to the public. In medicine, we have seen Cat Scanners replace Gamma radiation equipment for diagnosis, and we have seen Ultrasound replace Cat Scanners. The public policy response to this was to create Certificate of Need requirements so that the new technology would be limited to use in regional hospitals. The objective was to keep costs of writing off the obsolete equipment low, and maintain health care as an affordable need. The result of the restrictions has been widespread bypass of the restrictions, with the new technology meeting market

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demands for deployment in urban hospitals, but with virtually no penetration of rural areas.

The WUTC believes that there are ways to recognize the legitimacy of the claim of the elderly, disabled and low income person to "dial tone" for their emergent and social contact needs, without burdening industrial and small business users of the system to the point that inappropriate decisions by these users are motivated by the pricing structure. The WUTC does not believe that preemptive or prescriptive federal legislation is necessary now.

Studies which the telephone companies have conducted in cooperation with the Commission indicate that the funding of a universal service fund with a one cent per minute of use charge for premium access assessed against AT&T for interlata (cross-state) long distance, would be sufficient in 1984 to ameliorate perceived increases for most persons who receive some form of income assistance in the state. This approach would minimize the burden on industry and small business to that which flows from the practical necessity of paralleling interstate charges to long distance companies. To the extent that organizations which serve the elderly pay business rates, this approach will minimize the impact of adjustment in the pricing structure on such organizations.

The WUTC believes that basic service can be made available to the elderly at rates which preserve their ability to use the system for their emergent and social contact needs, in a way which is consistent with our social philosophy concerning maintaining the welfare of citizens who cannot afford services which are viewed as necessities. This philosophy limits support to that which is truly necessary. The linkage of subsidy through a universal service fund with a basic level of service, such as measured service, gives "dial tone" but limits the use of the system associated with subsidized service to necessary levels.

This approach is consistent with the economics of the telephone system as well. Althought flat rate pricing of local service is ingrained in the social fabric, the usage of the local switching and distribution network is not actually a "free good," once the "membership" of the charge for dial tone is paid. There is usage sensitive investment in the local exchange, and heavy users of that investment should pay more for its use than light users should.

Telephone rates have increased over the past few years. Part of that increase could have been avoided if control had been left with the states. There will be a perceived increase in the cost of telephone service when repricing of services occurs in 1984; but the cost of service must be borne by the end-user if the country is to retain its current advantage as the world's leader in communications.

In 1981, rate increases were impelled by the effect of inflation on the cost of capital for telephone companies, as well as the need to replace older mechanical switching equipment with new computerized switches, before the end of the useful lives of the older equipment. In 1982, the Federal Communications Commission ordered telephone companies to increase depreciation expenses figured in their rates. In order that the earned return on investment not be depressed, it was necessary for companies to seek to recover the higher depreciation expenses by raising rates. The WUTC resisted the exertion by the FCC of purported authority to increase expenses and generate rate increases for service all within the State of Washington. Because of this resistance, Pacific Northwest Bell showed higher depreciation expenses on its books than were included in its rates, and its intrastate earned return declined below that authorized by the WUTC. This effect was felt by the Independent telephone companies as a need for local rate increases, because the toll settlements paid by PNB to the Independents include recognition of PNB's actual earned return on investment.

Other FCC actions in 1982 which resulted in needs for rate increases were the decision to expense the station connections, or lines connecting the customers' house with the local distribution plant, rather than capitalizing such costs, and the freezing of the factors used in separating the telephone companies' investment into its interstate and intrastate components.

The effects of the dispute between the WUTC and the FCC over the setting of intrastate depreciation rates are shown in pending rate cases before the WUTC. The WUTC does not normally project rate increases for telephone companies, but believes that there may be some need to adjust rates when the FCC acts to remove existing customer premises equipment (telehpone sets) from the regulatory authority of the WUTC, as expected. If inflation is not kept under control, rate increases may be required. Also, if competitive forces imple the telephone companies to replace their older plant rapidly in order to retain business, rate increases may occur. The change to access charges is not, strictly speaking, a revenue increase, because the costs assumed by subscribers in their monthly rates will not be borne by the

long distance companies and competition should force long distance rates to decline as those costs are shifted. To the extent individual subscribers use little long distance service, they will perceive the shift to access charges as increases in their cost of telephone service.

There are major advantages in the long and short term which will result from the introduction of competition to the telephone industry. Long term advantages of introducing wide spread competition into the telehpone industry include the making available to the business as well as the residential user, of the benefits of technological improvements in communications. If the forces of competition are allowed to work, new and varied services will be offered, at prices which reflect the cost of each. The most efficient means of providing service will be found, because less efficient providers will not survive. Many services which are only now conceived of, which depend on an electronic link from the consumer to the world, will be provided as competitors seek profits from untapped markets. Costs of providing long distance service will be reflected in rates for this service, reducing substantially the perceived cost of using long distance.

Short term advantages include discouragement of uneconomic decision making which maximizes individual short term gain at the cost of unwisely using scarce resources. Long term disadvantages of introducing wide spread competition include possible effects on some existing individual providers of service, who may not survive in the new competitive environment. Short term disadvantages include the individual consumer reaction to price adjustments, to the extent these are not ameliorated by a universal service fund.

The Washington Utilities and Transportation Commission has recognized the importance of developing a methodology to facilitate repricing of telephone services, while protecting citizens, business and the local telephone network from extreme change in charges. In January of 1983, it appointed as its Good Officer, Mr. Douglas Owens, to work with citizens, groups representing citizens, and the telephone companies of the state to prepare for the Commission, a proposal based upon review of the issues, articulating an approach to be used at the state level to deal with recent changes in telecommunications brought about by recent FCC decisions which created a system of access charges.

Since the rule, developed by the group, is before the commission on August 31, 1983, it would be inappropriate for me to comment on it in detail. Mr. Owens will inform you of the issues dealt with by the groups, the process used to reach consensus and on the content of the proposal currently before the Commission.

Senator GORTON. Thank you.

Mr. Pardini?

Mr. PARDINI. Yes, Senator.

If I may, I will not submit written testimony to you. It was a last minute arrangement that I should accompany Commissioner Hall.

I am the new kid on the block in the commission, so I have many things to learn, but we have learned several things in the area of public hearings in which you may be interested, public hearings which the commission has held around the State. Incidentally, the commission is the only body which has held public hearings on the question of access charge, both in Seattle, Spokane, Olympia, and a series of about six hearings have been held. And as a result of that, I have drawn some conclusions which may not be backed by scientific study or anything along that line, but it would be very interesting to know what the people in the State are thinking, and I am sure that is what you have in mind.

Let me suggest to you that there is a substantial body of citizens in this State of all income levels and of all colors and creeds who just do not understand the concept of access charge. Maybe we should not have called it an access charge. They are saying if I do not use long-distance service, why do I have to pay this access charge? Or Mr. Commissioner, in lieu of my paying a monthly access charge, because the telephone is such a lifeline instrument

to me, I will be very happy to go down the street and use a public telephone and pay a higher rate if I can keep that lower rate.

I guess the thrust would be of the citizens that we have heard is the concept of the universal telephone service. They do not want to see rates driven to the point nor charges to the point where they may be forced off the system. These pleas are coming primarily from representatives of elderly, low income groups. That conclusion I think is a safe conclusion to draw, and I think it is readily apparent that it would be one of that nature.

At the same time, Senator, I am not sure that the costs that are being thrown around in the State, some of the early predictions of $40 and $50 telephone bills, are not reasonable costs. The commission has done some work, and we may well mirror the FCC intrastate access charge within the next few weeks in an attempt to prevent chaos. I think we have to have an orderly system if we are going to have something by January 1. So that may come about.

The important thing, I would think, would be if you move ahead with the bill, whether it is your bill, Senator Packwood's bill, whether it is the Wirth bill, the real question, it is a real economic question and a dilemma, is can we prevent bypass? I do not believe that any of the bills with their penalty fees will prevent bypass.

The second major question, even before moving to that, is are the costs realistically assessed? We have heard that long-distance calls subsidize local rates. I think that there are some new studies coming out that would say that that may not be the case.

During the course of the hearings, I used a common sense approach, and it just dawned on me when some citizens said I do not want long-distance calls. The telephone company has told me that they could not monitor incoming long-distance calls. I said to myself, suppose nobody answers the phone? The long-distance call will not be completed, and there will be no revenue generated. Hence, can you really charge all of these costs to the local loop?

I think it is something that we need to think about thoroughly. The commission is not unanimous in their approach to this, I would assure you of that. We have looked at suggesting maybe some additional delay. Some of us would favor moving ahead right with the FCC, the access charge, the FCC viewpoint. But we do know that we cannot stop the clock, that competition in long distance calls will take place, and it may be an interim period that we need before we proceed. We are going to have to allow that competition if we are going to continue to deliver it. The interim period may serve well for both the Congress and the Federal Communication, ourselves and State legislatures to more prepare ourselves for it.

Thank you.

Senator GORTON. Thank you.

Mr. Owens.

Mr. OWENS. Thank you, Senator.

Basically the approach that I understand the State has followed is believing that the existing division of revenues arrangement will go out of existence on January 1. We have set about trying to work with the telephone companies to come up with a replacement, and of course, the parallel investigation that was going on was the FCC's. When the FCC came out with its decision early this year, it

was factored in, and the approach, to answer the questions that Commissioner Pardini mentioned, was to try to work with the existing division of revenues and settlements data that all of the 25 telephone companies in Washington collect and calculate on an annual basis to create a view of the world under an access charge environment and come up with an estimate of what the cost would be for each company and its customers under a State access charge which was similar to a Federal access charge environment.

Basically that contains some assumptions, for example, that the revenue requirement for each company would be derived under the existing formula in separations using Pacific Northwest Bell's authorized rate of return. And there was no evaluation of whether the expenses and investments included in that calculation were reasonable at this point. But taking those assumptions into account and assuming that there would be a parallel intrastate access charge to the interstate as a source of revenue to meet a need so defined, then the residual was the customer access line charge requirement. I have attached [1] in my testimony the results of that.

Of course, these must be interpreted not as rates that are cast in concrete at this point. They are simply estimates of what can reasonably be expected for these companies to request the State commission to authorize. And there will be judgment exercised by the commission on those variables that I mentioned, that is, the reasonableness of the expenses and investment, and what is the appropriate return rate to be included as a part of any customer charge.

But even with those assumptions—and I believe that the way the calculation was done, it errs on the side of maximizing the size of the customer line charge. The charges range in 1984 from $1.18 to about $3.78 per month, with an average charge being $1.53.

Now, these charges, of course, have impacts which vary on individuals and on companies, and so subsequent to the preparation of those, there were further discussions held, and there is now consideration being given to a proposal to establish a cap on the charge which any given company would impose on its customers. And that would be $2 in 1984, and it might, if approved by the Commission, go as high as $3 in 1985. Now, this would mean that those companies who are in the $1.18 range, or in the lower range, would charge their customers approximately their own amount, adjusted in a slight fashion to fund the rest of the cap. But those companies who face their customers with charges larger than $2, or would ordinarily, would be subject to that cap. Our calculations are that approximately only 20 percent of the customers in the State would fall within the cap, although they are the customers in primarily the rural parts of the State.

Now, that answers the question Commissioner Pardini discussed about how the costs were calculated.

I think also of import is his other question of how can we stop bypass, and this was mentioned by some previous witnesses. There was discussion, as you can imagine, among the telephone companies and other people interested in this, for quite some time. I am concerned that the impression may be left that bypass is more imagined than real. I would just point out that Mike Woody, who is

[1] The attachments were not reproducible and are in the Committee files.

the director of telecommunications for the State Department of General Administration, went back to Washington, D.C. to testify before Congressman Swift on behalf of the State of Washington as a very concerned bypasser. They have a very strong interest in being able to bypass as a consumer.

You can see a television camera over here from Cox Cable Communications Co. They are a company which is involved in bypass in a very big way in conjunction with a company called Microwave Communications, Inc., right across the river in Portland.

So I do not believe that it is true that bypass is imaginary. I believe that the policies of the States and the telephone companies who have been working in this area believe that something needs to be done in order to allow the telephone companies to meet this competitive threat in the marketplace.

I would also answer a suggestion that the residential ratepayer does not want or use the kind of investment that is used to provide digital communications. I would point out that in the short run that may be true, but we are moving to an integrated switched digital network in the country; and second of all, even if it is true, I suggest that as a public policy, we should not want a dual telephone network in this country, one consisting of modern equipment for business and another consisting of older and not modern equipment for residential consumers.

I would also say that if it was intended as a criticism of my testimony that I indicated that universal service does include the needs of business, I believe that is consistent with the feeling that I had working with the telephone companies and the representatives of the small business community that they do consider access to the telephone network a very important part of their ability to do business, especially a small business. Perhaps there may be representatives here who will speak to that.

And as users of toll, small businesses certainly will stand to benefit as toll rates decline in response to the transfer of costs out of the usage charge for long distance.

Basically, I think those are all the comments I have. If you have any questions, I would be glad to answer them.

[The statement follows:]

STATEMENT OF DOUGLAS N. OWENS

Senators, thank you for the opportunity to present these comments on issues affecting local telephone rates, including the recent FCC decisions which created a system of access charges, and the Modified Final Judgment in the AT&T divestiture case. My remarks will focus on the response of the state of Washington, through its Utilities and Transportation Commission, to these changes; Commissioner Hall will offer a view of the goals and means adopted to achieve those goals in the legislation which is before you in S. 1660.

The approach of the state has been to encourage the exchange telephone companies and other interested groups to examine the issue from the standpoint of developing a solution which could be presented to the Commission. This involved articulating the approach, and then estimating the effects on the ratepayers. Discussions begain in February, and continue currently.

The plan developed by the group was to parallel the interstate plan, insofar as practicable, with the fixed element being the carrier's carrier charge, rather than the end user charge. The reason for this difference was the widely held belief that differential charges for the same good, i.e. carrier access, which would apply, based on the inter- or intrastate character of the end product made with that good, i.e., a completed long distance call, encourged economic inefficiency and created large ad-

ministrative problems. The residual element at the state level would be the end user charge.

The telephone companies did studies, based on 1981 settlement data, and budgeted growth estimates, to calculate the dollar effects of those changes from 1984 though 1989, according to the FCC's transition plan. The results of the calculation are attached as appendix A to these remarks. As can be seen, the 1984 effects range from $1.18 per month for Ellensburg, through $1.47 per month for PNB to $3.78 per month for St. Johns. In 1989, the figures range from $2.41 to $5.91. These numbers are exclusive of inflation. When added to the end user charges estimated for interstate access and a sample one party residential flat rate (1FR) in each company's largest exchange, the effects of paralleling the interstate plan at the state level produce 1989 monthly access bills of $19.29 for PNB and $23.69 for Continental. Ellensburg is still lowest at $13.83.

The numbers show that the effects of value of service pricing in the local exchange and cost of service pricing for toll access produce offsetting effects on the total monthly bill. That is, the large companies with urban exchanges have the highest one party flat residential rates, but the lowest end user access charges, while the reverse is true for the small, rural companies. The customers of the latter, while they face larger percentage increases, will still pay about the same, generally, for service per month, as the urban customers. The extent of toll-free calling which comes with rural service is markedly less than that for urban, but access, the ability to be on the network to make calls, will not be substantially more expensive for rural customers than for urban customers.

An unquantified, as yet, change in costs of service is the FCC-State Joint Board mandated reduction in the interstate allocation factor. This change will tend to increase the costs for those, mostly rural, companies whose interstate toll usage is greater than the arbitrary 25 percent limit selected by the Board. Other factors may tend to diminish the effect of this change, however.

One critical assumption in these studies is the maintenance of existing relationships between toll traffic minutes of use and expenses and investment. Each minute of use generates carrier's carrier access charges, during the six year phase down period, which offset the total non-traffic sensitive cost burden of each company. If those minutes are diminished, for example by bypass, the number of dollars generated to cover non-traffic sensitive costs will decrease, and more must be paid by end users.

After evaluation of these elements, some of those studying the issue at the state level concurred that placing a cap of $2.00 on the end user charge of each company produces endurable results, in combination with a waiver program, similar to the FCC's, for categories of customers who requires special consideration. The proposed approach is contained in a draft rule with comments, attached as Appendix B.

The state group considered the alternative of no action, and concluded that the risks posed of large users, such as the State of Washington, deserting the public network, were unacceptably high. Some of the other alternatives included in pending legislation or the FCC's reconsideration decision were also considered. The general approach of taxing bypassers was acknowledged to have some public support, but as the FCC's reconsideration decision makes clear, it is a quagmire of estimates and assumptions which appears highly vulnerable to procedural and substantive defeat. Procedural defeat could occur as entities tie up the collection effort with litigation about measurement or the legality of a $100,000 "fine" for activity which is not defined as a crime. Substantive defeat could occur as bypassers simply design around each method designed to capture them for taxation, a game in which the revenues relied on to balance local revenue requirements will never fully materialize.

The FCC's $25 per end charge for private lines seems intended more as a sop to blunt legislative action than as a serious attempt to deter use of private lines to bypass the switched message services. Clearly, a major motivation for obtaining a private line is to escape metering and the associated usage-based charges for NTS plant. Any serious attempt to compute an access charge for private lines based on usage must result in a much higher figure, which would necessarily impel the private line user to build its own system. The FCC acknowledged this point in rejecting the "Pure 1" approach in the Third Report and Order.

The state commission recognizes that a balance must be struck between economic efficiency and maintaining existing price levels in the name of universal service. The balance which the commission is considering moves in the direction of efficiency, but does not commit the state to any particular final result in terms of end user prices.

Senator GORTON. Well, Dr. Hall and Mr. Pardini, or Mr. Owens can answer if he wishes, I would like your comment on Senator Williams' and Representative Armstrong's position that the access charge decision should be reversed. They said it represents a misapprehension that long distance today is paying a disproportionate share of the joint operating costs, and that the access change decision therefore is not justified. I'm asking this question in light of something Mr. Pardini said. I gathered by one passing comment that Mr. Pardini tended to agree that the present distribution of costs was not disproportionate, yet he favors the access charge decision in any event.

So I would like that point clarified, and I would like your general view as to whether or not the philosophic and applied bases of the FCC's access charge decision are correct or not.

Ms. HALL. I am of the persuasion that it is.

Senator GORTON. That it is correct?

Ms. HALL. Yes; that it is correct; that we look at not the term subsidization, but in fact a repricing and a reallocation of costs to the end user, and making those services usage sensitive, I believe that the access charge decision will have a tendency to do that, particularly as it phases out over a period of time. I think it is good implementation of a nonexistent public policy, I am sorry to say, and I would hope that we might begin to give the FCC some policy guidance, and that is what, if Congress does anything, I would like for it to do.

Senator GORTON. What policy guidance would you have us give Congress?

Ms. HALL. I would hope that you would define the major economic objectives that could be accomplished by this divestiture and placing this telecommunications system of our country open and responsive to market conditions. I believe our current system is archaic. I do not know what your teenagers use, but my teenagers have been using the telephone to transmit data for 6 years. I think that it is just really pathetic if we lock our residential users out of it and the only thing we give them is a dial tone.

It reminds me of the discussions we had when we talked about establishing medicare and medicaid and the whole notion of a parallel system. This is not a time to keep people from the effects of technology. We can provide basic telephone service, but we cannot stop economic development in order to provide dial tone to some people.

Therefore, I thoroughly agree with the cost allocations as the FCC has talked about them so far.

Senator GORTON. Mr. Pardini.

Mr. PARDINI. Senator Gorton, the question basically is a question of public policy, and I think that public policy is not just access charges. I agree with Commissioner Hall that it should be a complete, comprehensive review of the entire telecommunications setup, including the cable TV, telephone, all of the types of telecommunications which are here, and those on the horizon, because in the next 5 to 10 years, those changes will be significant.

You asked if I concur with Senator Williams and Representative Armstrong in the possibility that costs may be misapportioned. I have never really analyzed the cost of the telephone company and

the Bell operating systems as they apportion these costs, their settlements manual. You mentioned earlier that there are 5 years of study by the FCC that says that long-distance calls do in fact subsidize local.

In the August 22 issue of the NARUC which arrived on my desk on Friday, I see a headline here, "FCC To Analyze the Effects of Federal Decisions on Local Telephone Service." The FCC has decided to carry out a comprehensive analysis on the impact of recent FCC decisions in the impending AT&T telephone divestiture upon local telephone exchange services and rates in response to the Michigan Public Service Commission. The first report is expected to be in the summer of 1984. Recognizing that the changes now being overseen by the Commission and the courts are unsettling to many, and that more evidence on the expected impact of these changes may be necessary to reassure the public, the FCC said it would begin a comprehensive analysis of the impact of its decisions and divestitures and require a report by December 1, 1983.

It then goes on to a series of all rates that have been filed, all of the information, what is the proposed dropoff rate, those types of things. So I guess, Senator, what the FCC is saying, we are looking at it again. I think the skepticism of who is subsidizing whom, or whom is subsidizing who, whichever you prefer, is a very healthy skepticism, and I think that there is no clearcut evidence other than someone has produced a manual and says that these are the fixed costs.

Mr. OWENS. May I answer that also?

Senator GORTON. Certainly.

Mr. OWENS. As to the issue of who is subsidizing whom, the answer may be in the final analysis that all of the users are subsidizing the stockholders. And I say that only in the sense that if we have new technology which is allowing new entrepreneurs to come in and provide service at a much lower rate than the telephone companies can charge, then any payment in excess of what the service could be provided at using the newest technology does represent in a certain sense a subsidy to stockholders.

But the question in the sense that I think Senator Williams and Representative Armstrong used it was in the sense of the allocation of the common costs of the loop, the wire that connects the central office to the subscriber, and the problem is that no one could ever ultimately tell you what was the proper share of cost for that line to be borne by the local, by the intrastate toll and by the interstate toll, because it is a common cost.

So all you can look to is what does the market say? Does the market by supporting entry of companies like MCI indicate that they believe that the price of long distance is too high? If the answer to that is yes, then you adjust the price of long distance. What Commissioner Pardini just said is equally true in the local exchange. If Cox Cable comes in and provides a substitute for local telephone service in the local exchange network using coaxial cable because the perception is that the shift of costs to the local user makes that a cheaper service, does regulation have a responsibility to do something about that? And the answer is yes to that, too.

Senator GORTON. Dr. Hall, in your written testimony you state that you favor a universal service fund funded by a 1-cent-per-minute surcharge on long-distance service.

In your view, how high could such a surcharge be before it would risk creating a serious bypass problem?

Ms. HALL. I think it might go up to 3 cents a minute, and by then we are beginning to reduce the spread where we may hurt competition.

Senator GORTON. In any event, you think at a 1-cent level, that risk does not obtain.

Ms. HALL. We have some notion of what it would require to subsidize services for approximately 140,000 households in the State of Washington which are currently eligible for some form of categorical assistance. That would take care of it.

Mr. OWENS. Could I comment?

I believe that 1-cent-a-minute figure, Senator, was derived from early estimates of what the FCC's per-minute premium access would have been on AT&T. I believe that is where the 1 cent came from. And the analysis was if that were mirrored at the intrastate level, would it produce enough money to do some good as a universal service fund?

Senator GORTON. And you feel that it would?

Mr. OWENS. I believe that was what Commissioner Hall said; yes.

Ms. HALL. That is correct.

Senator GORTON. Do you believe that the lifeline service that you are developing will meet the needs of the poor and those on fixed incomes?

Ms. HALL. I do. I believe that particularly if we have the opportunity to offer basic measured service which in fact will allow people to have a limited number of telephone calls, although that means their safety, their health is protected, they do have access to the telephone. Many are going to say, but I have to talk on the telephone for hours because that is my only social contact. That is the one we are still having to deal with. I am not exactly sure how to deal with that in terms of dealing with not only distance but also the time element of telephone.

However, again, if we consider that there are other forms besides talking on the telephone, and what we are going to be dealing with here, we just do not give away in order to protect that particular aspect of telephone service.

Senator GORTON. Do you propose some kind of means test for eligibility for such lifeline services, or would such services, however you define them, be available to anyone who sought to have them?

Ms. HALL. Having been an administrator of a social services agency in the State of North Carolina, I know what the costs of administering means tests are. I believe people are basically honest. I would in fact say those people who said they could not afford should in fact be so allowed.

Senator GORTON. Well, would it be on the basis that you would have to make a statement that you could not afford it? Or would the service be one that does not appeal to anyone who could afford more service and, therefore, be self-controlling?

Ms. HALL. The service is quite appealing. I have it personally myself. It is not a problem. I think that the service will be such

and its price would be such that people would elect to take that service and are doing so. I think perhaps more of them will take it after January.

Mr. PARDINI. I think, Senator, if I may comment on that, that the lifeline service would be an answer for low income, for elderly.

A more important question may be, will they accept it? Evidence so far as to the penetration of measured service or lifeline service offered extensively in the two major service areas of Pacific Northwest Bell in this State would indicate that over the last 2 or 3 years the market penetration has not been that significant. I will not give you the numbers. I am sure that one of the Pacific Northwest Bell representatives will give them to you today—because I have forgotten them and I have gotten them mixed, but penetration is not that significant. It can be an answer, but it is going to be an evolving process.

Senator GORTON. The reverse side of that coin, as Dr. Hall said, if it is a very attractive service, what happens if more people desire to have it than your charge or your subsidy can cover? By definition, this is a service being provided at less than cost.

Ms. HALL. We come again to the exact problem, and the one that we have with electricity, which is if you in fact begin to reduce demand, then in fact you are going to have some cost escalation.

Mr. PARDINI. You may have created another form of bypass.

Ms. HALL. It is a problem.

Senator GORTON. Thank you all very much for the help that you have given us.

Mr. PARDINI. Thank you, Senator.

Ms. HALL. Thank you, Senator.

Senator GORTON. The first of our formal panels will be Mr. Walker, representing Pacific Northwest Bell and Mr. Stern, representing General Telephone of the Northwest.

Mr. Walker, we will begin with you.

STATEMENTS OF GEORGE A. WALKER, VICE PRESIDENT, WASHINGTON/IDAHO, PACIFIC NORTHWEST BELL TELEPHONE CO.; AND WILLIAM E. STERN, VICE PRESIDENT, REVENUE REQUIREMENTS, GENERAL TELEPHONE CO. OF THE NORTHWEST

Mr. WALKER. Thank you, Senator Gorton.

My name is George Walker, and I am vice president for the State of Washington for Pacific Northwest Bell. My responsibility since 1968 has been the rate structure in the State of Washington under which our company operates.

It should not be a surprise to many of us who have been spectators to what has been going on in the telecommunications arena for the last 10 years to see these changes that are happening. I testified as part of a week long hearing in 1972 in Washington, D.C., where various members of the industry outlined some of the changes in telephone rates that would result from the introduction of competition into telecommunications. This was shortly after the FCC had introduced competition as part of the specialized common carrier decision in 1971.

As I am sure you will recall, as you were the attorney general here in Washington State at that time, Senator Gorton, under your

sponsorship, the Washington Utilities and Transportation Commission also appealed the specialized common carrier decision to the ninth circuit court, unsuccessfully. And here again, at that time, the evidence was that telephone rates would have to change as a result of the introduction of competition into an area that had been a regulated monopoly for 100 years, that basically some prices would have to go up to their costs and some prices would have to go down to their costs.

The access charge, the FCC access charge decision that we have been talking about here this morning, docket 78-72, deliberations first started in 1978. Hundreds of days of hearings were held, and thousands of hours of testimony were taken as to how best to adjust the existing systems of prices in this country as a result of this indoctrination of competition.

As an observer of that process and analyzing the final order in docket 78-72, and the several modifications that have taken place since last December when the docket was released, it is my general opinion that it is not perfect, but seeing the job that it has to do, that it is a reasonable approach to assigning costs between local service, long distance service, and setting up a new system of ground rules for this transition into a fully competitive environment.

I also notice that it has a 6-year transition period that was recently lengthened from a 5-year transition period, and the FCC has also announced a continuing surveillance procedure for that 6-years to analyze the impact on universal service.

As to the degree of flexibility, the best evidence that I can see is that they did modify it within the last 30 days, and I am convinced that if problems continue to develop as far as the implementation of this very complex proceeding, that the FCC is going to be flexible and responsive to whatever the situation is.

Now, I make that statement based on our company's 100 percent commitment to universal telephone service, and I say that for two reasons. Today in the State of Washington 98 percent of the households in our territory have telephone service, which is just about 100 percent saturation when you look at the number of people that are moving and so on. We have a commitment to maintaining this kind of saturation for several different reasons. We have it for obviously social reasons, and we also have this commitment for economic reasons because our basic investment and business in this State is a communications network. And obviously the value of that network would be considerably lessened if the saturation or penetration of households were to be less. And obviously a telephone network that reaches 98 percent of the people in a State has a greater value than a telephone network that reaches only 80 percent of the customers in the State.

So we do have this commitment to universal service.

Now, what is going to happen to that? If you look at the numbers that Mr. Owens and other people mentioned here this morning about what is generally going to be the impact on basic telephone rates as a result of the changes that we are seeing and as a result of this 6-year transition, it says to us that, for example, in Pacific Northwest Bell territory, that with a State access charge and a Federal access charge, that in 1984 rates for flat rate local tele-

phone service would go up $3.40, roughly, and that at the end of the transition period, 6 years from now, that the rate increase would be in the area of $8 or $9, based on these changes that we are talking about here today.

So if you average it out, it says that telephone rates over the next 6 years, the monthly bill will probably go up about $1.25 each year. Now, whether or not that would cause someone to have to leave the network, I cannot say, and I have not seen that kind of economic data. But on the other hand, I do feel that between the options that we have of other lower priced services such as budget measured service, basic measured service, and with the option that the FCC has given us to apply for a waiver for budget or lifeline type services, that we can adopt our pricing structure to keep everybody on the network, which is one of our objectives.

Now, the other side of the coin is that if we attempt to place artificial costs or taxes on access to our network, we know that we are going to drive more of the large users who have the technology and the ability off the network. Bypass is not a new phenomenon. Bypass is something that has been occurring for the last 10 or 15 years. Today in the State of Washington, most of our larger users like the State of Washington with their SCAN network, the Boeings, the Weyerhaeusers, the other large users no longer utilize the public switched network for their communications because they have other means, other private satellite type means or other common carrier type facilities. They have left the network.

If you will take a look at our remaining customers, they are highly concentrated and, for example, if we were to lose 125 locations—I am basically saying if a bypass company were to build some kind of a facility to 125 locations in the State of Washington—we would lose another 20 percent of our total business and WATS long distance type revenues. If we lose that, that means that the basic rate would probably have to go up something over $3, but more importantly, it would leave the public network with the existing cost. We would lose the revenue, not the cost, and that would have to be redivided among the rest of the small long distance type users.

So our basic concern—and I think it is one that the FCC has expressed, and I think with good reason—is that the long distance network could be priced out of the reach of the small residential type long distance user.

So basically, we feel that if there needs to be a subsidy, that there is a pretty good subsidy procedure built into the FCC access charge order. For example, there is a high cost factor that is quite effective, and from studies I have seen, it can actually cut in half the actual cost of providing service in some of the high cost areas in the State of Washington.

As Commissioner Hall described, there is a means to waive this access charge altogether for certain classes of service or types of customers, and we are analyzing that.

So our basic plea is that rather than introduce another set of unknowns and another possible bureaucracy on top of something that has already become quite complicated, that we give the existing system a chance to work and work together to modify it as necessary.

Thank you.
[The statement follows:]

STATEMENT OF GEORGE A. WALKER, VICE PRESIDENT, WASHINGTON/IDAHO PACIFIC NORTHWEST BELL TELEPHONE CO.

I'd like to thank you for inviting me to talk with you today about the current status and our future plans for local telephone service here in the Northwest, particularly in regard to elderly and low-income customers.

My name is Georga A. Walker and I'm vice president for Pacific Northwest Bell's Washington-Idaho area. My offices are at 1600 Bell Plaza, Seattle, Wash. 98191. I am also chairman of the King County, Washington Citizens' Regional Advisory Committee for Washington's Department of Social and Health Services. These responsibilities have keenly sharpened my sense of awareness and concern for the elderly and low-income customers' problems.

Their concern about increases in their telephone bills are shared by all of us at PNB. I know you too are concerned about the prospect of higher phone bills, and we're working hard to keep you informed about what we're doing to keep phone service affordable and available for all.

To begin, I'd like to review our current programs for keeping the price of basic telephone service affordable, and tell you about a new program just now being put together to target additional support for those who truly need help.

First, let's review what's causing the increase in phone rates. While many point to the breakup of the Bell System as the primary cause, competition has actually triggered the change in pricing. Competition in telecommunications was introduced long before divestiture became a reality.

Competition would have caused price increases for local service whether or not divestiture had ever occurred. Competition drives products and services prices toward cost and forces the elimination of any subsidies. This is neither complex nor surprising.

I testified over ten years ago before a committee in Washington, D.C., about the economic impact of competition on universal telephone service. The conclusion was clear then if you introduced competition into a monopoly environment it would drive rates to cost. Although all of this was not our idea that's what is happening now.

Competition brings more choices for consumers, but it also means we have to charge more for services that were previously subsidized and, less for those which have been priced artificially high. For example, long distance has historically contributed a significant amount to help support basic exchange service. On January 1, 1984, we will begin to lose that subsidy.

Our Vancouver customers pay $10.80 for one party flat rate service today, which is less than half of the actual cost. We've been able to keep the price that low because of the subsidy from long distance. (The Seattle one party flat rate today is $12.50.)

We have a longstanding commitment to the goal of universal service. We've done this because it makes good business sense—universal service enhances the value of our basic product—the network.

Today, some 98 percent of the homes in our serving territory have phone service. Our objective is to keep it that way.

In meeting the communications needs of our customers, we provide a variety of options, including a premium flat rate service which allows unlimited local calling. If you take a look at the consumer price index on a variety of goods and services, you'll note that flat rate phone service is a bargain by any standard.

Even so, we have alternatives to flat rate service. Our measured service options for home users are priced at even lower rates. Basic measured service includes a $3 calling allowance and unlimited incoming calls. After the $3 allowance is used up, additional outgoing calls are charged by the number of minutes used. In addition, discounts are offered based on the time of day the call is made. I should note this is full quality individual line service available 24 hours a day.

A second measured service offering is our budget option, designed for customers who want to keep their telephone bill to an absolute minimum.

These measured services are now available to almost 90 percent of our residence customers.

Budget measured service is different from standard measured service in that each outgoing call is charged by the length and time of day it's made. For some customers, this is the best bargain of all. Even when the leasing charge for a telephone set is included, premium flat rate service and budget measured service are real bar-

gains, now even more than a few years ago. Today flat rate service takes less than 4 percent, and budget measured service takes less than 2 percent of a monthly social security allotment.

Of course, there is ever growing pressure to reprice telephone rates in the competitive environment. One of the results of this is that we need to bring down long distance rates while local service rates will move closer to its cost.

We do expect, however, to receive some level of support, from the long distance services we keep, and the fees we will charge other carriers to use our local network.

In repricing the services we offer we must avoid artificially stimulating the creation of bypass networks by large users which are not in the best interests of the public and average customers. Those large customers will build separate and alternative communications networks which circumvent entirely the public long distance network, and in some cases the local network too if they are overcharged by the telephone company for public network service. Some of these firms also have the capacity to resell the use of their private networks to others.

If the rates for using the public long distance network are inflated too far to subsidize local service, bypass becomes inevitable, depriving the public network of revenue support. The result is additional pressure to increase other rates. Eventually, this cycle could destroy the Nation's public telephone network.

Bypass is not an imagined threat. We already have a number of customers in the Pacific Northwest using their own networks. The U.S. Government, major newspapers and television stations, the Boeing Co., the Washington and Oregon State governments, lumber companies, and the city governments of Seattle and Portland are examples. Other companies and organizations no doubt will construct their own networks in the future, if the price to use the public network continues to be artificially high.

With bypass, telephone companies immediately lose revenues, but not cost. In fact, if business customers in only 125 locations in the State of Washington elected to bypass the public switched network, we would lose 20 percent of our total business long distance and WATS revenue. As a result, local exchange rates would have to be increased $3.14 a month to replace the lost revenue. In addition, long distance rates would be higher for the remaining customers on the toll network because they would then be sharing the same fixed cost.

Some plans being debated propose to charge bypass carriers to support the local network so old subsidies can be continued. The problem is we know of no practical or economical way to charge people for using their own private communication systems that are totally outside the local public network. Yet that's what would have to be done for such a program to be effective. I question whether a program such as this could even be enforced, even if you determined it was in the public interest.

Plans of this kind are like taxing people who drill their own wells to provide support for the local water company so it can keep rates to its customers below cost, or taxing railroads to subsidize airports.

In spite of well-intentioned efforts to tax bypassers, technology and innovation in this field are moving so fast that many bypassers will have systems that simply can't be detected. Keep in mind that bypass can run the gamut from CB radio to satellites to cable TV systems. The ones that would pay some tax or license fees would, in effect, then be carrying increased support burdens to compensate for those that are not reported, or that manage to avoid the tax through litigation or other means.

The State of Washington has taken a national leadership role in initiating a detailed analysis of the precise effects of customer access charges on local rates.

This study was sponsored by the Washington Utilities and Transportation Commission, with the full participation of 25 telephone companies throughout the State.

The study demonstrates clearly that the highest flat rate for basic service anywhere in the State in 1984 will be less than $17, which includes an intrastate customer access charge. The vast majority of Washington citizens will pay an even lower rate—down to as little as $8.34—in 1984.

Obviously, factors such as inflation will impact the price of basic service in the future. However, looking ahead a full six years—to 1989—at PNB we're anticipating an increase of only approximately $8 per month as a result of all customer access charges. Let me add an important point here. As I mentioned earlier, long distance rates will go down. This reduction will provide an offset for the access charges, and because the average home customer uses over $20 in long distance each month, may even result in an overall reduction. As a matter of fact, we have just filed for reductions in rates for long distance calls in Washington State to be effective January 1.

This kind of specific and detailed analysis should dispel the fears of those alarmists who have been forecasting a doubling or tripling of phone bills within a year.

I'd like to mention one other point in reference to this special Washington study. We've all heard the concerns being expressed about unacceptable impacts on rural ratepayers. The Washington study shows that customers in the small rural community of Forks, Washington (population 3,060) will pay less for their phone service than customers in much larger metropolitan areas such as Seattle.

The evidence is clear to me that any conclusion about rates in rural areas reaching unaffordable levels is without any basis in fact, at least here in the Northwest.

Yet, we realize that some customers may not be able to afford even the lowest price option for phone service with such an increase. To meet that need, we strongly encourage a direct and targeted subsidy to the individual customer based on need as opposed to one that is dispersed in a general or geographically related fashion.

PNB is already actively involved here in this State, along with the commission, other phone companies and consumers, to determine how a locally administered universal service fund might provide direct assistance to those who cannot afford basic telephone access.

And, as you know, Governor Spellman has announced the formation of a special statewide task force to review these same issues and make recommendations. In addition, the Washington State Legislature has established a joint Senate-House interim committee to review all utility regulation and recommend any needed changes in State procedures.

I'm confident that these local efforts, in concert with the FCC's access charge plan, will blend together to create a sensible and equitable end result for Washington telephone users.

The most recent order by the FCC on this subject offers a special new opportunity. It permits telephone companies to apply for waivers to the customer line access charge for lifeline-like budget services. We are currently considering application for such a waiver. This is the new program I mentioned earlier to give those that need it direct targeted assistance.

Our plans call for a certification process where the customer is provided with lifeline type service based on an established criteria such as, for example, State low-income standards. We want to keep the administration of this type of program simple, and we see no problem in doing that. We have considerable experience already with a similar certification program for handicapped customers using directory assistance. And, we are presently analyzing the exemption and discount programs now being used by King County Metro, Seattle City Light and some of the PUD's.

There would be no need to establish any new agency or organization—either internally within our business or within Government—to oversee this program. We believe that this approach, coupled with our efforts to offer a range of options, provides a practical framework for maintaining affordable telephone service for all.

In summary, then, Pacific Northwest Bell is working to develop options targeted for those who can be identified as having specific support needs. By doing this, basic telephone service will continue to be affordable in the future as in the past. And we will continue our efforts to make universal service remain a reality in this State.

Finally, we firmly believe that local efforts—with active involvement of our State regulators and other members of the local industry—can solve these problems best. I'm convinced that approach—together with the FCC's access charge program—is the best way we can assure that the nationwide public switched network remains the invaluable asset it has become today while, at the same time, continuing to make access to a telephone line affordable and available to all. I'm happy to say we have a good start on these local efforts already.

Thank you for this opportunity to share these views with you today. We stand ready to work with you in any way as you continue your review of these serious issues.

I'd be happy to take questions now.

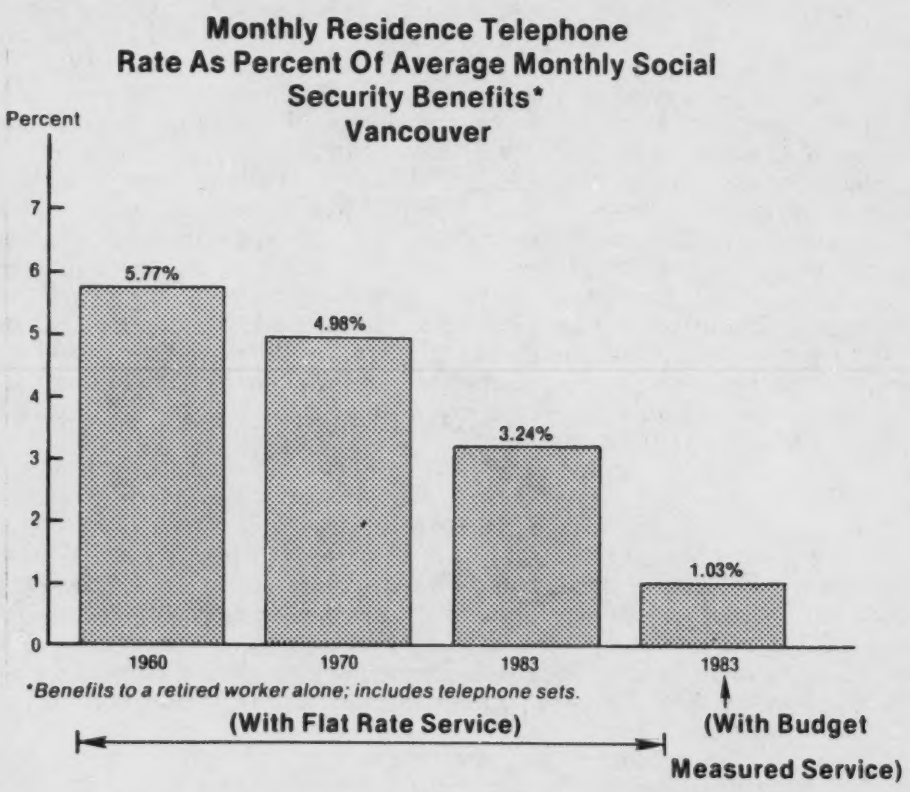
RESIDENCE BASIC TELEPHONE SERVICE RATES—STATE OF WASHINGTON (VANCOUVER)

Service type	Monthly rate	Typical usage rates
Premium flat rate	$10.80	Included.
Basic measured service	[1] 5.80	4 cents initial minute. 1½ cents additional minutes.

RESIDENCE BASIC TELEPHONE SERVICE RATES—STATE OF WASHINGTON (VANCOUVER)—Continued

Service type	Monthly rate	Typical usage rates
Budget measured service	4.05	4 cents initial minute. 1½ cents additional minutes.

[1] Includes $3 local calling allowance.



EFFECT OF BYPASS ON BASIC SUBSCRIBERS—WASHINGTON

Washington business MTS/WATS revenue percent	Number of business locations	Increase in monthly access line rate with bypass
10	22	$1.57
20	[1] 125	3.14
30	367	4.71

[1] Represents .1 percent of the total 99,926 total business locations in Washington. If these locations were bypassed, subscriber monthly line rates would have to increase $3.14 to offset the contribution from the lost toll revenue.

Senator GORTON. Thank you, Mr. Walker.
Mr. Stern.
Mr. STERN. Thank you, Senator.

My name is William Stern, and I am vice president, revenue requirements for General Telephone Co., of the Northwest.

I would like to make some general statements about our primary responsibility, the provision of reasonable and efficient telecommunications services to our customers.

The telephone industry, both the Bell companies and the independents, has built the most cost-effective system in the world. The system was designed to offer quality service at a reasonable price. As this body well knows, the present pricing structure will soon change. There is no doubt that under any pricing system, telephone costs in the future will rise, especially for those services such as local exchange service, which are priced below cost.

With the introduction of competition and deregulation of segments of the industry, prices will move toward costs.

Even in the industry, there are differences about the final customer impact of these changes. There have been harrowing headlines about doubling and tripling of local exchange rates, primarily in the rural areas. Mr. Owens testified earlier as to the range of intrastate access charges in the State of Washington, somewhere in the range from $1 to $3.89, $3.90. For General Telephone Co., of the Northwest, the intrastate access charge in Washington would be $1.33. The Federal access charge, as established by the FCC in its decision released on August 22, would be $2 for residential customers and $6 for business customers.

Why is all of this happening?

With the development of competition in the intercity telecommunications market and the divestiture of the Bell operating companies from AT&T, the partnership arrangement between AT&T and the local exchange carriers for the division of toll revenues will end, 4 months from today. That division of revenue process has traditionally provided a substantial contribution to the nontraffic sensitive costs of providing local telephone service. The FCC has established a workable plan to compensate local telephone companies for the use of their facilities.

The FCC has ordered that all telephone users, both customers and interexchange carriers, be charged access fees for the use of the local telephone company's network.

The FCC's order as adopted in December and subsequently modified, is the product of careful and painstaking examination of this subject by the Commission. The docket began in 1978. We believe that the plan developed is fundamentally equitable and workable.

We do not agree with congressional suggestions that the access charge be imposed entirely on the interexchange carriers and major long-distance users. Such a move would only heighten the very real capability of large users to bypass the local exchange network.

Within our operating territories there are major entities who have already constructed their own facilities, Boeing, Tektronics, and the State of Washington itself are among the organizations who are presently bypassing the network. We are also aware of other entities who are considering establishing their own networks. Technology is driving the costs of bypass down, making it economically attractive for an increasing number of entities. As more and more large users elect to bypass, the burden of the nontraffic sensi-

tive and overhead costs is spread over a smaller group of customers, thereby increasing the pressure on local rates even further.

We recognize the concerns of Congress regarding the possible impact of access charges on residential rates and the desire to deal directly with the problem of bypass of local exchange facilities by large users. However, we do not believe that bypass of the local network can be prevented or prohibited, or that it would be practical to impose a user fee or tax on bypassers.

There is one vital concern that must be addressed, universal service. Universal service must be maintained, and we believe it should be dealt with by the States through the offering of lifeline service to low-income subscribers rather than through the continued subsidization of all local exchange subscribers, some of whom do not need such a subsidy. The FCC in its order on reconsideration has a process by which waivers for classes of customers of the access charge are possible. The concern about universal service is also reflected in the FCC in the Joint Board's decision to establish a high cost fund reflecting that in some areas of the country, primarily rural areas, it is very expensive to provide telephone service. It should be recognized that this universal service fund would be paid for by the interexchange carriers.

Our analysis of the access charge order released on August 22 has not been fully completed yet. However, assuming our analysis does not reveal major problems, we believe the FCC's access charge plan is an equitable and workable solution to the recovery of costs once subsidized by long distance toll revenues. It is the product of years of study and balances four somewhat conflicting goals, the first of which is universal service; second, dealing with the bypass problem; third, the encouragement of efficient and innovative telecommunications services; and fourth, the need for financially viable local telephone companies.

We stand ready today, as we have in the past, to work with Congress on this and other telecommunication legislation. However, we believe that the FCC's access charge plan should be allowed to go into effect.

Thank you.

[The statement follows:]

STATEMENT OF WILLIAM E. STERN, GENERAL TELEPHONE CO. OF THE NORTHWEST, INC.

My name is William E. Stern.

I am Vice President—Revenue Requirements for General Telephone Company of the Northwest with direct responsibility over the Company's five-state area for revenues and tariffs, regulatory matters with state commissions, and relations with exchange and interexchange carriers.

I would like to make some general statements about our view toward the future as it realtes to our primary responsibility . . . the provisions of reasonable and efficient telecommunications services to our customers.

The telephone industry, principally since the passing of the communications act of 1934, has built the most cost effective telephone system in the world. Compared to most other countries, that service is a communications wonder. The system was so designed to offer quality service to just about every business as well as both city and farm homes at a reasonable price.

As this body well knows, the present pricing structure will soon change. There is no doubt that under any pricing system, telephone costs will rise in the future for services such as local exchange service, that have been priced below cost. With the introduction of competition and the deregulation of segments of the industry, prices must move towards cost.

The inflationary pressures that have plagued all industry have eased, but they have only eased, not ceased. We have a three-year labor contract with increases averaging 6 to 8 percent each year. State and local taxes have steadily gone up and we see no relief in the future. Interest rates, while declining from a year ago, are now on the rise again and future capital requirements will be fueled by many factors—particularly if the growth of the late 70s returns. All of these impact customer rates.

Under the proposed new access charge structure, the degree of impact on customers is still uncertain. It is known that some of the revenue burden will shift to the end-user, or customer.

Even in the industry there are differences of opinion as to the final customer impact. There have been some harrowing headlines of doubling and tripling of rates, particularly in the rural areas.

Preliminary studies in conjunction with a joint industry and regulatory task force in Washington State have produced preliminary data that indicates starting in 1984 that the intrastate access end-user charge on a per company basis would range from a low of $1.04 to a high of $3.89 a month per line. This would average in the neighborhood of $1.53 a month, with GTNW at around $1.33.

The interstate end-user access charge as established by the FCC in its decision on July 27, 1983, would be $2 per month per line for residential customers and $6 per month for business customers. The figure for residential service increases by a dollar in 1985 and another dollar in 1986, while the rate for business remains at $6 for those years.

Why is this all happening?

With the development of competition in the intercity telecommunications market and the divestiture of the Bell Telephone Companies by AT&T, the divestiture ends the partner-like arrangement between AT&T and local exchange carriers for the division of long-distance toll revenue. That division of revenue process has traditionally provided a substantial contribution to the non-traffic sensitive costs of providing local telephone service. The Federal Communications Commission has established a workable plan to compensate local telephone companies for use of their facilities by interchange carriers.

The FCC ordered that all telephone users, both end-users and interexchange carriers would be charged access fees for use of the telephone network. For end-users, the access fee would increase over a transition period of six years so that the non-traffic sensitive costs would eventually be shifted to customers.

Interchange carriers also would pay for access to the local networks to originate and terminate interstate and intrastate calls. Such payments would primarily be for the traffic-sensitive portion of the network.

The order also calls for AT&T to pay a premium fee for access to the networks of local telephone companies. This premium, originally pegged at $1.4 billion, was increased to $2.2 billion.

The FCC's order, adopted in December, 1982, and subsequently modified in July of this year, is the product of a careful and painstaking examination of this subject by the commission. We believe the plan is fundamentally equitable and workable.

We agree with the FCC that it is appropriate to charge a fixed monthly fee to cover a portion of the cost of the dedicated facilities linking the customer with the telephone company's switching equipment. It should be noted that the non-traffic sensitive investment to provide service for a subscriber who elects to make few long-distance calls is no less than for a subscriber who elects to make many such calls.

We do not agree with congressional suggestions that the access charge be imposed entirely on the interexchange carriers and major long-distance users. Such a move would only heighten the very real capabilities of large users to bypass the local exchange network. Bypass exists today, it is not a "strawman." Within our operating territory there are major entities who have constructed their own facilities. Boeing, Tektronics and the State of Washington itself are among the organizations who are bypassing the network.

Boeing presently connects several of its locations in the Puget Sound area with microwave facilities. It is presently evaluating proposals that would meet its communications needs throughout the United States largely through private networks.

Tektronics has established a multi-million dollar high speed data microwave system between its facilities in Beaverton, Oregon and Vancouver, Washington.

The State of Washington's network consists of four nodes located in Seattle, Olympia, Vancouver, and Spokane. Each of these nodes has multiple hubs. The network is available not only to the State and its agencies, but also to counties, municipalities, schools, and PUDs.

We are also aware of other entities who are presently considering establishing their own networks. Technology is driving the costs of bypass down, making it economically attractive for an increasing number of entities. As more and more large users elects to bypass, the burden of the non-traffic sensitive costs and overhead costs is spread over a smaller group of customers thereby increasing the pressure on rates.

GTE recognizes the concerns of congress regarding the possible impact of the access charge order on residential rates and the desire to deal directly with the problem of bypass of local exchange facilities by large users.

However, we do not believe that bypass of the local network can be prohibited, or that it would be practical to impose a user fee or tax on bypassers. Technology is changing rapidly and attempts to define telecommunications will probably be obsolete by the time the ink is dry. It is my understanding that there may be constitutional problems on imposing a tax or fee on bypassers. We are also concerned that potential litigation of a user fee or tax on bypassers would as to the sources of our revenues. Additional uncertainty create uncertainlty should not be introduced into our industry during these turblent times.

There is one other vital concern that must be addressed—universal service. We do not believe that the access charges mandated by the FCC order will jeopardize the continued viability of "universal telephone service."

Universal service should be dealt with by the States, through the offering of a lifeline service to low-income subscribers, rather than through the continued subsidization of local exchange subscribers who do not need such a subsidy. We believe that subsidies should be targeted based upon a means test. GTE is in the process of developing a proposal. The concern about universal service is also recognized in the Joint Board's decision to establish a high cost fund reflecting that in some areas of the country, primarily rural areas, it is very expensive to provide telephone service. It should be recognized that this universal service fund would be paid for by the interexchange carriers.

While S. 1660 is silent on the matter, several other bills recently introduced in congress would transfer from the FCC to the States jurisdiction over the setting of telephone company depreciation rates. Such an action could jeopardize adequate capital recovery by the telephone industry and would thereby pose grave long-term problems for consumers as well as the industry.

Our analysis of the access charge order released on August 22 has not yet been completed. Assuming our analysis does not reveal major problems, GTE believes that the FCC's access charge plan is an equitable and workable solution to the recovery of costs once subsidized by long-distance toll revenue. It is the product of years of study and balances for sometimes conflicting goals.

Universal Service

Dealing with the Bypass Problem

Encouragement of Innovative Telecommunications Services

The need for Financially Viable Local Telephone Companies

The Company, however, stands ready today—as it has in the past—to work with congress on this and other telecommunication legislation.

Senator GORTON. Thank you.

Mr. Walker, in your written testimony you state that bypass becomes inevitable when local rates are inflated too much in order to subsidize long-distance service.

First I would like you to tell me how far you think too far is. Second, if average rates for local service will go from the $11 or $12 range per month to $20 in the course of the next 6 years, and if the Perl study is correct that that would cause you to lose 10 percent of your customers, is that not too far?

Mr. WALKER. Well, to answer your first question, Senator Gorton, going back to the question, to the statement that Mr. Owens made earlier, it is really a matter of economic tradeoff as to how much you can charge to use the local network before someone can replace that local network, and we are basically talking about the cost of the facility from a business or residence to the telephone office. And every study that I have seen says basically that that facility, no matter how often it is used or where it is, the aver-

age cost is around $20 a month. And there is really no way to get around that.

So basically, anyone can build a comparable facility and create this bypass network for probably on an average of about $20 a month.

As your second question, I have heard the Perl study referred to here several times this morning, and basically the Perl study is an outdated study that was made with a set of assumptions that are not meaningful. The Perl study was made a number of years ago by Dr. Perl, who was with NERA, the National Economic Research Association, and it used 1970 census data, and it made the assumption that the change in telephone cost would happen immediately. So even if the study were up to date, that it was a meaningful study with current data, it makes the assumption that whatever increase it is happens immediately, not over a 6-year period as this transition plan dictates.

Senator GORTON. Are you saying that local rates can go to $20 a month without any significant number of customers moving to alternate services, because no one could provide an alternative for less than that?

Mr. WALKER. I do not—I think yes, local rates to the local residence customer can go to $20 a month without a large number of customers leaving the network. I think it would be an infinitesimal number would leave if that were programed over this 6-year period, because it is only about a $1.25 a year.

Senator GORTON. Do you have any data as to what percentage of your customers you would lose, not to alternative services, but just lose off the network at that price after 6 years?

Mr. WALKER. Our most current, of course, we have to look at what experience we have had with rate increases, and for example, in Oregon where we have had rate increases over the last 18 months or so, where basic residence service has gone from the area of $8 to $14, which is a significant increase, we have not seen anyone leave the network. We still see that we have 98 percent of the houses with telephone service. We have seen customers move to budget measured service or basic measured service which has increased.

Senator GORTON. So they move from one category of service to another rather than off the network? That is your experience?

Mr. WALKER. Yes.

And of course, Commissioner Pardini mentioned that the development of measured service was not that extensive in Washington, and he is right, because the differential has been less between measured service. And basically we find that when there isn't much difference in cost, people will take the Cadillac type of service as opposed to the basic service that would probably meet their needs.

It is interesting because in any given month 60 percent or more of our customers in Washington would be better off with measured service than flat rate. They would pay less for their existing usage. But people, if they do not have the economic pressure, evidently would rather pay more each month if it is a little more and stay with the flat rate service.

Senator GORTON. I have another question for either of you to answer. Is the FCC's access charge decision the only effective way to deal with bypass? Were other proposals, alternative proposals, presented at the FCC on that subject?

Mr. WALKER. Well, I guess I have looked at, as I recall now, Senator Gorton, there are about 13 different pieces of legislation pending in Washington on this issue, both in the House and the Senate, and I have looked at how each one of them addresses this bypass issue and how a tax would be put on the bypass or on the satellite or on whatever other facility it is, and I have not found one that has a meaningful way it could be collected or enforced. There may be some way, but I have not seen it yet.

Senator GORTON. So you do believe that the FCC's way is the only effective way?

Mr. WALKER. I think that the FCC's way does not put an economic premium on bypassing. It is not going to drive people into bypass. I think the public network is the best way to serve a lot of people that an artificial tax would drive off the network, and we would lose a valuable national resource that we have in this network today in the country.

Senator GORTON. Do you agree with that, Mr. Stern?

Mr. STERN. The FCC, Senator Gorton, in its deliberation considered various methods of allocating these common costs, pure 1, pure 2, mixed 1, mixed 2 were some of the methods that the FCC considered during its deliberation. I think the bypass problem led it to a type of pure 2 solution. So I think they did consider other means of handling bypass but felt that the decision that they reached is the most equitable one.

Senator GORTON. The two members of the legislature who led off this hearing stated their belief that monopoly local telephone services have been subsidizing competitive and specialized services.

Is this true? If so, why should such a subsidy be permitted to exist?

Mr. WALKER. I would say unequivocally that is not true. I have never seen a study that has been made that shows that local telephone service is subsidizing anything.

Mr. STERN. I would agree. I have seen some studies. However, I do not agree with the premises under which those studies are based.

Senator GORTON. What were those premises?

Mr. STERN. They allocate a significant portion of the local loop to toll. In other words, the costs of the local loop, a significant portion of those costs are allocated to toll.

Mr. WALKER. I guess that if I could add to Mr. Stern's answer, that one study that was presented here as part of the last rate proceeding in the State of Washington was put in by a consultant by the name of Wilson for the WUTC, and his methodology made no, took no responsibility for the cost of the local facility or the local loop, which is really a great way of walking around the problem.

Senator GORTON. He took no responsibility for costs allocated—to what?

Mr. WALKER. That is right, it was not allocated to anything. It says that if you take all the money that you get for local telephone rates and then take the traffic sensitive switching cost for local

rates, that the dollars collected are more than the cost, which is true. But two-thirds of the cost of local telephone service is the fixed local wire from the house to the telephone office, and that study ignored that cost, which just is not economically sound.

Senator GORTON. Are the fixed costs of local service higher than they would otherwise be because the system is used for long-distance service as well as for local service?

Mr. WALKER. No, they are not, because the fixed cost is there whether one local call is placed or received, or whether hundreds are received. They do not change.

Senator GORTON. Thank you both very much for your enlightening testimony today.

The next panel will be Mr. King, Mr. Gleason, Mr. Erickson, and Mr. Appelo.

We will begin with Mr. King.

STATEMENTS OF DAVID D. KING, CHAIRMAN, WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION SETTLEMENTS COMMITTEE; A. M. GLEASON, CHIEF EXECUTIVE OFFICER, PACIFIC TELECOM, VANCOUVER, WASH.; JON C. ERICKSON, VICE PRESIDENT AND GENERAL MANAGER, PENINSULA TELECOM, FORKS, WASH.; AND CARLTON APPELO, MANAGER, WESTERN WAHKIAKUM TELEPHONE CO., GRAYS RIVER, WASH.

Mr. KING. Thank you, Senator, for the opportunity to come before this panel.

My name is Dave King. I am president of United Telephone Co., of the Northwest, which is headquartered in Hood River, Oreg., and I reside in White Salmon, Wash.

I kind of have two hats on today because the first hat is I am representing the Washington Independent Telephone Association as chairman of the settlements committee to discuss with you some of the studies that we have done and conclusions that we have come to. And also, obviously, I am part of United Telephone.

First, I want to assure you that when we began doing the analysis within the State as far as the independent telephone companies and the Pacific Northwest Bell, our primary concern was universal service, and our primary concern was what is going to happen to the cost of telephone service. And I think earlier you heard some of the initial numbers that we came up with, a high figure of $47, which dealt with no universal service fund and merely took a simple basis of assumptions and said that is what it would cost.

If I may oversimplify a little bit, it may help. The issue that really is at stake is how do you pay for what we call nontraffic sensitive, which is very simply the wire that goes from the customer's premises out to the pole and back into our office, and a little portion of the equipment in the office. And over the years, there has been a contribution from long distance, or a subsidy, to support that, and the point remains, should you continue some form of subsidy or should you have each cost causer pay for their particular share of that investment?

I think that identification of those costs is relatively simple, and I am very confident that the numbers we have used, particularly in the earlier years of 1984 and 1985, are very accurate. We do know

actually what the investment is, and we do know actually what the costs are for all the companies. So the issue of really knowing what those costs are I do not think is a problem.

The issue has been how do you allocate those costs? Who pays for it? And a portion of those local costs, a great portion have been allocated or considered to be used by long distance; therefore, long distance paid for part of those costs. That is what we are dealing with.

If you reviewed the latest set of numbers that we used as far as the association goes, it shows the 1984 effects. You can see the range is 26.9 percent on the low hand increase, up to a high of 117 percent increase. But it still makes the highest rate in 1984 slightly over $13.

One of the considerations that is before the Commission now would limit that increase to the $2. Mr. Owens talked about the $2 cap. So what it would mean in 1984, the maximum increase for any residential customer would be no more than $4, the $2 for the interstate and the $2 for the intrastate.

We also attempted to quantify out to 1989 the effects, and those are some of the other numbers which range in the $20 to $25 range. These numbers have various assumptions in them as to what the final FCC ruling would be in 78–72. It is our best estimate at the moment that, again, the 1984 and 1985 numbers are very accurate. The 1989 numbers are possibly understated from what we currently understand as far as the FCC, but in my judgment not significantly understated.

Within the association, it would only be fair for me to say that we have had heated debate about the need for legislation or not a need for legislation, and I think that the panel today will be able to give you a better flavor for some of those differences because many of the companies feel similar to what you heard previously, that there is no legislation needed at the moment, and others within the association feel very strongly that some form of legislation is needed to protect universal service.

Speaking for United Telephone, our position is at the moment the access charge arrangement appears to be a reasonable way to approach the transition, and that it ought to have an opportunity to be tried, and if later there is a need to introduce some form of subsidy or contribution, that it can relatively easily be done within the framework even of the access charge arrangement. It merely means that rather than eliminating the subsidy in total, it could be retained and use that methodology to do it.

One final comment, I think that there is a great amount of concern on the part of all the companies in the association that the public network survive. If the public network does not survive, in our opinion, particularly rural America will be most negatively affected because it will drive up the unit cost of providing basic service. As previously has been mentioned, there are extreme examples of bypass, and I think the Federal Government is a pretty good example; State government and large users today have taken a significant amount of the traffic off the network because they could do that at a cheaper rate than paying the message toll rates.

So we are very strongly encouraging that the issue of the public network not be ignored. It must survive. And if it survives, we

have the best opportunity to provide continuing universal service over the next number of years.

I might just add one comment from United's point of view. We feel very strongly that the next few years gives us the opportunity to take advantage of the technology under the current FCC framework. If we can take advantage of the technology, I am confident that we can control and possibly even reduce the costs that we talk about for providing basic access, and if we are good managers and innovative, I think we can provide other services that we can sell to our customers that can continue to make some form of contribution to offset the basic costs of providing dial tone.

So we feel very strongly that the opportunity is there and we in the industry would like to have an opportunity to operate in a competitive environment.

Thank you.

[The statement follows:]

STATEMENT OF THE WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION, BY DAVID D. KING, PRESIDENT, UNITED TELEPHONE CO. OF THE NORTHWEST

My name is David D. King, President of United Telephone Company of the Northwest.

I am here today as a representative of the Washington Independent Telephone Association ("WITA"). WITA consists of 24 independent telephone companies dedicated to modern and efficient telephone service at affordable prices (Exhibit #1). The member companies serve over half of the state's land area but only 580,091, or 27.6 percent, of all access lines in Washington State (Exhibit #2). These areas are geographically diverse and primarily rural.

WITA's purpose today is to outline the work it has been doing in Washington State on deregulation and to assess the telephone rate impact of various regulatory decisions made in the last several years. It has emphasized the recent Federal Communications Commission ("FCC") decisions on access charges.

COMMUNICATIONS ACT

In the early part of this century before extensive regulation, numerous telephone companies began to offer service in the same areas. Frequently, these companies did not interconnect with one another and customers desiring to call all other stations in the same town had to have two or three telephones in their businesses or residences. Congress concluded that this duplication of service facilities was an obvious waste which, among other things, threatened its desire for the widespread provision of telephone service to all members of the public. In order to resolve these problems, Congress passed the Communications Act of 1934 and specifically stated that one of the primary purposes of the Act is:

"* * * to make available, so far as possible, to all of the people of the United States a rapid, efficient, nationwide—wire—communications service with adequate facilities at reasonable charges * * *."

This language embodies the concept that has become known as "universal telephone service". The specific meaning given to the concept of universal service by federal and state regulators over the past half-century involves the pricing of local service at affordable levels to allow almost all households to have a telephone. Because the provision of local telephone service is both capital intensive (i.e., it requires considerable investments in switching, transmission and distribution facilities) and expensive, contributions from other services were used to keep monthly rates below actual cost.

CONTRIBUTIONS TO LOCAL SERVICE

Over the years, a dual system of contributions was developed by the industry and its regulators. First, the rates for telephone service provided to business customers were set at levels two or more times higher than for residence customers even though the costs to the telephone company were generally the same. The disparity was justified by the belief that the service was worth more to business (the so-called "value of service" concept), and business was better able to bear the added expense.

The second major source of contribution to local service is long distance (or toll) revenues. A part of the investment in facilities, which are jointly used to provide both local and long distance services, is allocated to and considered as a cost of long distance service and recovered from the pool of interstate long distance revenues (known as toll settlements). These jointly used, or common, facilities have traditionally included the telephone instrument (known as Customer Premises Equipment, or CPE), the premises or inside wiring, and the outside cable pair from the customer's premises to the telephone company's serving central office (or exchange) switching facilities (commonly referred to as the "local loop") as well as part of the Central Office (Exhibit #3).

THE SEPARATIONS PROCESS, COMPETITION AND DEREGULATION

The allocation of these common facility costs between local and long distance services is known as the "separations process". Over the years, the industry and federal regulators have agreed to a variety of methods to allocate the costs of these common facilities between local and long distance services, the most recent being the Ozark Plan, developed in 1970. However, due to the increase in long distance usage during the 1970s and the effects of inflation on the cost of new plant, the allocation has grown at an unexpected rate and produced a disproportionate increase in the contribution from long distance to local service.

As the separations process shifted an increasing proportion of the common facility costs to long distance service, other parties became interested in and began to provide interstate long distance service to business customers at a more attractive price. These new entrants provide service to business and high use customers at a more attractive price because the FCC has not required them to bear the same responsibility, i.e., contribute to the cost of local service.

At about the same time, the confluence of computer and communications technology caused the FCC to reexamine the prohibitions against telephone company participation in data processing that were established almost a decade earlier. In May, 1980, the FCC issued its first of three orders (the Second Computer Inquiry, or "Computer II"), which found that the public interest would be best served by competition, rather than regulation, in the enhanced services (i.e., network services which alter the code or protocol of communications) and terminal equipment (or CPE) markets. Accordingly, effective January 1, 1983 the provision of new CPE and enhanced services by telephone companies was deregulated and the investment in such equipment was removed from the regulated rate base.

The Computer II decision also precipitated a change in the separations process. Since part of the investment in CPE is allocated to interstate toll in the separations process, the deregulation of CPE required new procedures to eliminate that allocation. In February, 1982, the FCC adopted a plan, which commenced on January 1, 1983, to eliminate the investment and certain related expenses in CPE from the separations process at the rate of 1/60th per month. This will permit a uniform and gradual transition over five years. At the time this plan was adopted, the FCC recognized that the loss of this source of toll revenues, which heretofore provided a contribution to local service, must be recovered in the future through increases in the customer's local rates.

RECENT PRICING DECISIONS

As the separations process allocated greater proportions of the common facility costs to long distance service, business customers, who use long distance service to a greater extent than residence customers, were found to bear more of the contribution. These increasing costs for business customers generated great concern among some regulators, legislators, and telephone companies as other parties began to offer long distance service. There was concern that unless business service was based on cost, and its historical support of residential rates reduced, then the business customer would seek alternative telecommunications services and bypass the traditional telephone network. The question was whether bypass constituted a major threat to universal telephone service, since the loss of a substantial amount of revenues from large customers would mean that telephone companies would have to recover more of their fixed costs from remaining customers. In order to avoid such a dramatic (and nonphased) shift of costs to local customers, it was suggested that there would have to be an increase in local service rates to recover a portion of the cost of providing that service in order to allow business and long distance service rates to decrease to a level closer to their costs.

ACCESS CHARGES

Given the introduction of competition in CPE and enhanced services and their subsequent deregulation, and given that economic theory and economic conditions dictated that residential customers should bear more of the costs of the local loop, the FCC adopted an interstate Access Charge Plan in February, 1983, which it recently modified on reconsideration. The objective of the plan is to eventually recover from all local telephone consumers, on a flat rate (rather than usage) basis, all of the costs of the jointly used local loop allocated to interstate toll service.

During a six year transition period commencing January 1, 1984, residence customers will pay a maximum flat charge of $2.00 per month in 1984, $3.00 per month in 1985 and $4.00 per month in 1986, while business customers will pay a maximum of $6.00 per month during the first three years. The balance of the costs in 1984, 1985 and 1986 will be recovered from interstate long distance carriers. In each of the last three years of the transition the balance of the costs paid by interstate long distance carriers will be shifted to the telephone companies' residential and business customers. At the end of the transition period, it is contemplated that access charges will be the same for both residential and business customers.

THE IMPACT OF CHANGE

During periods of significant change, a positive response is required if progress is to be made.

The Washington Utilities and Transportation Commission ("Commission") has shown an active concern for the state's telephone consumers and is working to develop positive responses to the changes that are apparent for the telephone industry in Washington state. It has encouraged extensive discussion on a formal and informal basis of major trends and topics and it has not avoided or ignored the difficult issues.

WITA is also responding to the challenges of change. As early as December, 1980, at the Commission's request, WITA prepared a study of the effects of the competition on telephone ratepayers in Washington state. Since then WITA has continued to closely monitor the issues and ramifications of competition, deregulation and access charges and has actively participated in all hearings and forums conducted by the Commission addressing deregulation and its implications. In addition, on March 22, 1983, WITA formally appeared before the U.S. House of Representatives' Subcommittee on Telecommunications, Consumer Protection and Finance to address the impact of deregulation in Washington state.

Prior to WITA's appearance before the U.S. House of Representatives' Subcommittee on Telecommunications, and since its appearance, WITA members and Pacific Northwest Bell ("PNB") have actively participated in a Commission Task Force to determine the actual impact of access charges on the telephone company customers in Washington state. Based on the most recent available data, the residential one-party flat rate which companies presently charge and would charge in 1984 and 1989 follows:[1]

Company [1]	1983	1984	1989
Asotin	5.00	8.34	18.69
Continental	12.55	16.95	23.69
Cowiche	6.50	11.03	16.24
Ellensburg	8.25	11.43	13.83
General	12.36	15.69	21.29
Hood Canal	6.50	10.87	17.85
Inland	6.30	10.50	20.16
Kalama	6.00	10.28	16.70
Lewis River	5.00	9.62	18.41
Mashell	7.10	12.58	18.29
Peninsula	8.74	13.35	19.52
Pioneer	7.00	12.08	18.08
Prescott	6.20	9.24	15.91

[1] In determining the 1984 and 1989 rates, the following criteria were employed:
A. Each company determined its prospective 1984 intrastate toll revenue requirement.
B. It was assumed that intrastate access charges would equal interstate access charges.
C. CPE would be phased out over five years beginning January 1, 1983.
D. All study data was based on 1984 dollars with no projected growth or inflation.

Company [1]	1983	1984	1989
St. John	6.00	11.78	18.08
Tel Utilities	6.10	9.75	15.97
Tenino	6.00	11.34	17.33
Toledo	6.00	11.89	18.19
United	4.65	10.12	15.85
Western Wahkiakum	7.15	12.01	18.29
Whidbey	7.50	11.93	17.85
Yelm	6.00	10.32	15.10
Pacific NW Bell	11.15	14.62	19.29

[1] Three companies are not specifically identified in the chart because their data was either combined with that of another company or they did not have data available at this time.

As indicated in the preceding chart, one-party residential customers in Washington state will experience increases in their bills in 1984 ranging from 26.9 percent to 117.6 percent. The percentage increase, of course, depends on the present one-party rates charged to those customers.[3]

THE FUTURE OF UNIVERSAL SERVICE

The Commission and the industry have attempted to quantify the ramifications of the regulatory changes during the past few years on our customers. It is obvious that substantial increases in rates are going to occur in the next several months and will continue to occur during the remaining portion of the transition period. Neither the Commission nor the industry are insensitive to these increases.

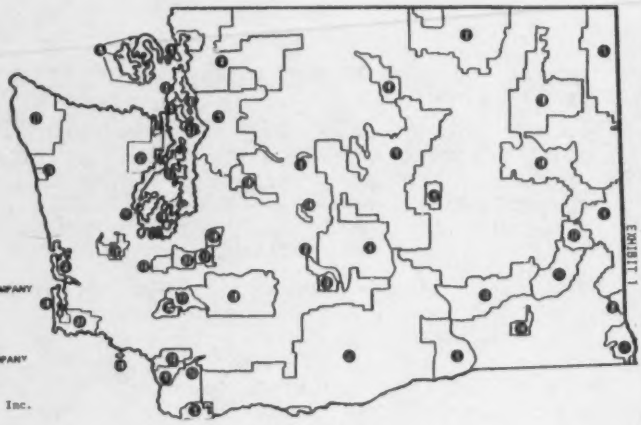
WITA's members are major providers of basic telephone service in this state, and, as such, are vitally interested in the preservation of universal service. Independent telephone company customers are not just the primary source of income to the companies but they are also the companies' primary concern in management and operation decisions. In considering positions on proposed telecommunications legislation, the effects on our customers will guide our member's decisions. If a customer "drops-off" the network for economic reasons, the companies and their remaining customers will be under a greater financial burden. Therefore, we need to price our services at affordable levels.

While the members of WITA have not taken an official position on S. 1660 or any other proposed legislation, I can assure you that they all support the need for affordable universal service and will work to maintain that objective.

[3] At the present time, the Commission is considering adopting a rule governing intrastate access charges. A suggested change to that rule would limit each company's intrastate customer access line charge to a maximum of $2 per month during 1984. If this proposed change is accepted, the customers of the companies identified in Exhibit 4 would have the rate set forth in the preceding chart reduced by the amount reflected in the Exhibit.

THE INDEPENDENT TELEPHONE COMPANIES OF WASHINGTON STATE

1. ASOTIN TELEPHONE COMPANY
Asotin, WA 99402
(509) 243-4111
2. CONTINENTAL TELEPHONE OF THE NORTHWEST
Bellevue, WA 98004
(206) 453-2000
3. COWICHE TELEPHONE COMPANY
Cowiche, WA 98923
(509) 678-4111
4. ELLENSBURG TELEPHONE COMPANY
Ellensburg, WA 98926
(509) 925-1425
5. GENERAL TELEPHONE OF THE NORTHWEST
Everett, WA 98206
(206) 258-5321
6. HAT ISLAND TELEPHONE COMPANY
Langley, WA 98260
(206) 444-6878
7. HOOD CANAL TELEPHONE COMPANY
Union, WA 98592
(206) 898-2481
8. INLAND TELEPHONE COMPANY
Roslyn, WA 98941
(509) 649-2211
9. INTER-ISLAND TELEPHONE COMPANY
Friday Harbor, WA 98250
(206) 378-2177
10. KALAMA TELEPHONE COMPANY
Kalama, WA 98625
(206) 673-2755
11. LEWIS RIVER TELEPHONE COMPANY
LaCenter, WA 98629
(206) 263-2191
12. MASHELL TELEPHONE COMPANY
Evansville, WA 98328
(206) 432-6161
13. McDANIEL TELEPHONE COMPANY
Salkum, WA 98582
(206) 985-2111
14. PENINSULA TELEPHONE & TELEGRAPH COMPANY
Forks, WA 98331
(206) 374-6212
15. PIONEER TELEPHONE COMPANY
Lacrosse, WA 99143
(509) 549-3511
16. PRESCOTT TELEPHONE & TELEGRAPH COMPANY
Roslyn, WA 98941
(509) 649-2211
17. ST. JOHN TELEPHONE COMPANY
St. John, WA 99171
(509) 648-3322
18. TELEPHONE UTILITIES CORPORATION*
Nesaco, WA 98624
(206) 642-2311
19. TENINO TELEPHONE COMPANY
Tenino, WA 98589
(206) 264-2816
20. TOLEDO TELEPHONE COMPANY
Toledo, WA 98591
(206) 864-4562
21. UNITED TELEPHONE OF THE NORTHWEST
Hood River, OR 97031
(503) 386-2211
22. WESTERN WAHKIAKUM TELEPHONE COMPANY
Gerrys River, WA 98621
(206) 465-2211
23. WHIDBEY TELEPHONE COMPANY
Langley, WA 98260
(206) 321-1111
24. YELM TELEPHONE COMPANY
Yelm, WA 98597
(206) 458-2171



*Name changed to Pacific Telecom, Inc.

EXHIBIT 1

EXHIBIT 2

Washington State Telephone Companies

Company	*Access lines*
Asotin Telephone Co	772
Continental Telephone of the Northwest	43,142
Cowiche Telephone Co	1,341
Ellensburg Telephone Co	12,556
General Telephone of the Northwest	387,603
Hat Island Telephone Co	34
Hood Canal Telephone Co	597
Inland Telephone Co	654
Inter-Island Telephone Co	3,913
Kalama Telephone Co	1,471
Lewis River Telephone Co	1,823
Mashell Telephone Co	1,389
McDaniel Telephone Co	2,072
Pacific Northwest Bell	1,521,340
Pacific Telecom, Inc	62,627
Peninsula Telephone & Telegraph Co	3,924
Pioneer Telephone Co	778
Prescott Telephone & Telegraph Co	889
St. John Telephone Co	610
Tenino Telephone Co	1,618
Toledo Telephone Co	1,276
United Telephone of the Northwest	43,793
Western Wahkiakum Telephone Co	829
Whidbey Telephone Co	5,024
Yelm Telephone Co	3,854

JOINTLY USED, OR COMMON, TELEPHONE FACILITIES

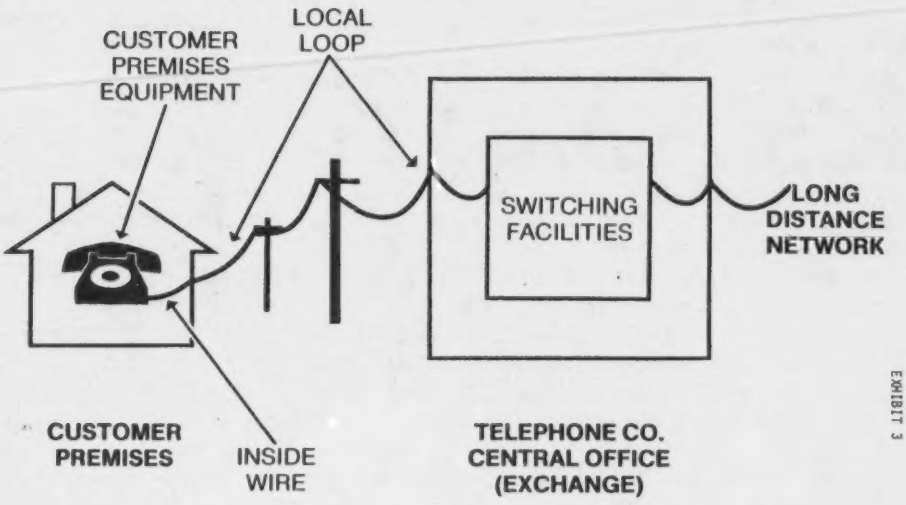


EXHIBIT 3

EXHIBIT 4

Company	*Reduction*
Continental	$0.40
Cowiche	0.53
Hood Canal	0.37
Inland-WA	0.20
Kalama	0.28
Lewis River	0.62
Mashell	1.48
Peninsula	0.61
Pioneer-WA	1.08
St. John	1.78
Tenino	1.34
Toledo	1.89
United-WA	1.47
Western Wahkiakum	0.86
Whidbey	0.43
Yelm	0.32

Senator GORTON. Thank you, Mr. King.

Mr. Gleason?

Mr. GLEASON. Thank you, Mr. Chairman, for the opportunity to appear today.

My name is Al Gleason. I am chairman and chief officer of Pacific Telecom, a Vancouver, Wash., based telecommunication holding company. Alascom, a PTI subsidiary, is the long lines carrier providing service to and within the State of Alaska. Exchange services are provided through six Northwestern States, the States of Alaska and Wisconsin. We provide service to approximately 210,000 exchange customers in 143 exchanges for an average of 1,470 per exchange. Fifty percent of our exchange serving areas are to communities with less than 500 access lines. Many of our subsidiary telephone companies must be categorized as high cost because of the

sparsely settled areas and the very difficult areas to serve in Alaska.

In general, there are two basic areas that I would like to comment on. One addresses the approach of legislation proposed in S. 1660, and the second is an issue we would like to see in that legislation if it should pass.

As I indicated earlier, Pacific Telecom's operating companies provide service to remote areas. We have been concerned with the development of a high cost factor due to those high cost areas and have consistently cooperated with other rural telephone companies to file comments before the FCC in their various proceedings. The high cost factor designed by the Joint Board really addresses our concern in those areas.

We feel that the Joint Board FCC procedure should be allowed to be implemented with the monitoring of those results. We feel that it is a reasonable solution and that the Senate committee and House committee should continue oversight but allow it to work.

The universal service fund established by proposed S. 1660 provides 90 percent recovery of the universal service costs in excess of 110 percent. This is a higher level of support than the Joint Board, and certainly if the legislation passes, we support that concept.

There are many instances where we serve small businesses in the same rural areas that the Senate bill addresses. We believe that the Senate bill should include single line business telephones in addition to residential, if it moves. I would recommend that that provision be considered.

Pacific Telecom does not support the provision in S. 1660 eliminating end user charges for nontraffic sensitive costs. The competitive marketplace will not permit loading of competitive services that are not incurred by the providers of those services. Given the rapid technological developments occurring, we do not believe that the current legislation can keep companies on the public network when they have an economic incentive to bypass.

With regard to basic telephone lifeline service, we believe the only workable lifeline rate to be a low-rated monthly service with message calls billed over a specified minimum. It can be self-policing, and we feel any other attempt would be disastrous.

If it is the goal of Congress and the regulators to promote competition and recognize the advance of technology, some portion of the burden earlier borne by long-distance service must be shifted to the end user. The current access charge environment in which we have devoted man-years of time in programing, computer studies, traffic analysis, we believe to be a step toward that direction.

Since I ultimately believe user charges are in our future, Pacific Telecom recommends that end user charges be allowed to go in place January 1 with continual monitoring by FCC and Congress. If undue burdens are placed on the end user as a result, changes can then be quickly made.

The second point I wish to address in my testimony today involves Alascom, Inc., which is a long lines carrier providing toll service to, from and within the entire State of Alaska. It has been our experience that legislation is prepared to address major issues surrounding AT&T and its Long Lines carrier. Obviously, however, there are radical differences between AT&T and Alascom. Alascom

has been faced since its inception in 1971 of providing service to all rural Alaska communities with 25 or more residents. For the past 10 years we have spent in excess of $450 million to provide those essential services, including native health services and instructional TV throughout the State of Alaska.

In the legislation proposed under S. 1660, there is no recognition of the continued national policy for toll rate integration between Alaska and the contiguous 48 States, nor for the recognition of higher costs in doing so. We believe that the language attached to my testimony today would provide a vehicle to support the policy, national policy of rate integration between Alaska and the lower 48 States.

Representatives of the company have been discussing the amendment proposed in this testimony with members of the Senate committee, and we remain available to do so in the future and answer additional questions.

Once again, Senator, I thank you for the opportunity to appear today.

[The statement follows:]

STATEMENT OF A. M. GLEASON, CHAIRMAN OF THE BOARD OF PACIFIC TELECOM, INC.

Thank you Mr. Chairman for providing the opportunity to appear before the Senate Committee in this very vital issue. In order to assist you in understanding the testimony I am about to give as well as the various forces that play in the development of our Company's position, I would like to provide you with some background information concerning Pacific Telecom, Inc. My name is Al Gleason; Chairman of the Board and Chief Executive Officer of Pacific Telecom, a telecommunications holding company. Alascom, a Pacific Telecom subsidiary is the long lines carrier providing service to, from and within the state of Alaska. Exchange services are provided to telephone subscribers in smaller exchanges in rural areas throughout six northwestern states, the states of Alaska and Wisconsin. We provide service to approximately 210,000 exchange customers in 143 exchanges for an average of 1470 per exchange. Our largest exchange is Kalispell, Montana, with approximately 13,600 exchange lines. 50 percent of our exchange serving areas have less than 500 access lines. Many of our subsidiary telephone companies must be categorized as high cost companies because of the difficulty in servicing telephone subscribers in sparsely settled areas as well as the difficulty of providing service in an area such as Alaska with its difficult terrain, great distances and extremely sparse population.

We are presently in the process of acquiring two operations in the State of Alaska serving approximately 34,000 subscriber access lines. We are making such acquisitions with the belief that regulated communications companies will share in the growth of this developing state by providing essential communications. In general there are two basic areas on which we wish to comment. One addresses the approach of the legislation proposed in Senate Bill 1660 and the second raises an issue which we wish to have included in the proposed legislation. The first area of comment involves the proposed legislation's treatment of local exchange companies.

As I indicated earlier, Pacific Telecom, Inc.'s operating telephone companies are responsible for providing service generally to remote and rural areas in the states in which they serve. As a result, we have been particularly concerned about the development of a high cost factor to support universal service to these difficult to serve and low density areas. Pacific Telecom joined with four other Rural Telephone Companies to file comments in FCC Dockets 78-72 and 80-286, specifically emphasizing the threat that deregulation and FCC actions may have on universal service. This group did propose a plan to address the rural problem and participated in an industry task force to further develop a compromise plan. The high cost factor designed to preserve universal service developed by the Joint Board and proposed in their most recent public meeting on April 15, 1983, is, at least partially the result of this effort. The FCC and the Joint Board are making provision for a universal service fund as well as continually monitoring the results of their decisions. We have not seen the proposed final order of the Joint Board and do not expect its dissemination to the public prior to the end of August or the first part of September. Nevertheless

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we do believe that their approach as we understand it, is a reasonable solution and should be implemented subject to regulatory and legislative monitoring.

We support the high cost factor mechanism proposed by the Federal State Joint Board in Docket 80-286. The Universal Service Fund established by the proposed S. 1660 provides 90 percent recovery of all universal service costs in excess of 110 percent of nationwide average costs. This is a higher level of support than proposed by the Joint Board. Pacific Telecom, Inc. would support such a mechanism to ensure the provision of universal telephone service if legislation is deemed necessary at this time.

There are a few additional comments which I wish to make concerning the legislation as proposed. The limitation of support from the Universal Service Fund to rural and residential customers only and the definition of basic telephone service as limited to residential service creates a dichotomy which might not necessarily reflect the need of the telephone users. There are many instances, particularly in the serving areas of Pacific Telecom's subsidiaries where small businesses operate with a single line telephone serving the same rural and residential users covered by the legislation in the eight states in which we serve. Although business and residential service can be simply defined, I would recommend that some provision be made for single line business customers who do not have a large customer base on which to spread their costs. Pacific Telecom does not support the provision in Senate Bill 1660 eliminating end user charges for non-traffic sensitive costs. A competitive marketplace will not permit loading costs on competitive services that are not incurred by providers of these services. Given the rapid technological developments occurring we do not believe the current legislation can keep companies on the public network when they have an economic incentive to bypass.

With regard to basic telphone life line service, I would reflect that although such service can well be a very acceptable and worthwhile offering on the part of the telephone company, the reduction in associated revenues must be compensated for through higher rates in some other area. The legislation does not indicate how such revenues would be generated and as such raises a concern for telephone operating companies. We believe they only workable lifeline rate to be a low monthly rated service with message calls to be billed over a specified minimum.

If it is the goal of Congress and the regulators to promote competition and recognize the advance of technology some portion of the burden earlier borne by long distance service must be shifted to the end user. In addition, the Company has been actively engaged with five state commissions as well as internally in the preparation of access charge tariffs and rates. The Company is undertaking major changes in its Data Processing programs in order to accommodate the new method of billing and charging carriers and exchange customers for the use of its local exchange facilities. If a significant change were to occur at this time before implementation, a large portion of this effort to date would have been wasted. Since I utimately believe end user charges are in our future, Pacific Telecom, Inc. recommends that end user charges be allowed to go into place on January 1, 1984 with continued monitoring both by the FCC and a Congressional oversight group. If undue burdens are placed on certain subscribers as a result of the access charge requirements, congressional and regulatory changes could then be introduced. The repricing issue caused by competitive entry into a regulated industry is extremely complex and difficult to accomplish. The FCC is well down the road of resolving the issue while at the same time seeking, through monitoring the high cost factors, to mitigate any adverse impact. We believe such a plan should be allowed to go into place with adjustment at a later date if required following further regulating and congressional review.

The second point that I wish to address in my testimony today involves Alascom, Inc. which is the long lines carrier providing toll service to, from and within the entire state of Alaska. It has been our experience that as legislation is prepared to address major issues surrounding AT&T and its long lines capacity, definitionally Alascom, being a long lines carrier, is painted by the same brush. Obviously, however, there are radical differences between AT&T long lines and Alascom, Inc., not only in size but in ability to cost average and the underdeveloped nature of territory served.

Alascom has been faced, since its inception in 1971 with the responsibility of providing long distance telephone service to all areas with 25 or more residents within the state of Alaska. When Alascom assumed responsibility from the Air Force in 1971 the major service available was provided as an adjunct to the backbone military system. Alascom, committed initially to invest an additional $28 million in the development of the communications system in the state. Over the past ten years the amount necessary has actually been in excess of $450 million. These capital dollars were expended to develop the most extensive satellite network in the country,

backup terrestrial facilities in and out of Alaska, transportable earth stations for activities as diverse as crucial military services, major public events, oil exploration, basic communications systems with native health service, and educational and instructional TV throughout the remote areas of Alaska.

In the legislation proposed under Senate Bill 1660 there is no recognition of the continued national policy for toll rate integration between Alaska and the contiguous 48 states nor is there provision for the higher costs and the requirement for continued support of these costs to provide toll service to or, from and within Alaska. There is attached to my testimony as Exhibit 1, amending language which the Company would suggest for inclusion in Senate Bill 1660. We believe that this language would provide continuing support both for the policy of rate integration and the high cost to provide interstate toll service to and from the state of Alaska. Because similar high costs to some extent are quite possible in other offshore domestic points, Alascom recommends that its language address the broad issue of domestic offshore points rather than the specific issue of Alaska. A final point which I would make concerning the support of interstate service between Alaska and the domestic 48 states addresses the issue of the cost to the country as a whole to provide the necessary support for the development of this service. In a letter of December 20, 1979, directed to Senator Goldwater, Mr. Henry Geller, Then Assistant Secretary of Commerce and head of NTIA indicated that the cost to provide such support to Alaska would be approximately $150,000,000 or ½oth of one cent for each origination and terminating interexcharge call in the lower 48. The imposition of such a minimal surcharge on lower 48 interexchange calling when related to the benefits that would flow not only to the offshore points but also to all of the telephone users in the lower 48 would be in my opinion in the public interest.

Representatives of the Company have been discussing the amendment proposed in this testimony with members of the Subcommittee staff as well as staff members of various Committee members. We will continue to make ourselves available to answer any questions of Committee members or their staff and to provide whatever additional information might be necessary in their opinion. Once again, Senator, I wish to thank you for your personal interest in this very critical issue facing the telecommunications industry and for the opportunity you have provided for me to appear.

EXHIBIT 1

THE AMENDMENT

1. Add a new subsection (e) to S. —— at page 3, line 19 of the Bill, before the definition section, as follows:

"(e)(1) The joint board shall also ensure that basic interLATA service to, from and within any domestic offshore point will be available at reasonable rates. The Joint Board shall designate additional Universal Service costs to be collected through the Universal Service Charge Schedule established under subsection (c)(1) for this purpose.

"(2) A company that provides basic interLATA telephone service to, from or within any domestic offshore point shall be entitled to receive its reasonably incurred Universal Service Costs.

"(3) For purposes of this title, Universal Service Costs shall also consist of the costs for basic interLATA service to, from and within any domestic offshore point which exceed 110 per centum of the average cost of providing, throughout the United States, basic interLATA service, that is comparable in distance, duration and time of day."

2. Redesignate subsections (e) and (f) of the Bill (p. 3, line 19 and p. 4, line 7) as "(f)" and "(g)".

3. Revise subsection (f) (as redesignated) as follows;

Revise the definition of "basic intraLATA telephone service" (starting at p. 3, line 25) by adding the following at p. 4, line 2, before "; and":

"For offshore points, each exchange area established by the State regulatory commission shall be treated as a LATA for the purposes of this title;".

4. Redesignate the remaining subsection (3) of subsection (f) (as redesignated) (p. 4, line 3) "(5)".

5. Add two new definitions before "; and" on p. 4, line 2, as follows:

"(3) 'basic interLATA telephone service' shall mean that telephone service between LATAs which is provided to the general public on a universal basis over the public switched telephone network for use by natural persons to communicate with each other by voice;".

"(4) 'domestic offshore point' shall mean Alaska, Hawaii, Puerto Rico, and the United States Virgin Islands".

AMENDMENT TO PRESERVE AFFORDABLE LONG-DISTANCE SERVICE FOR OFFSHORE POINTS

The problem

The costs of providing all services to offshore points, especially Alaska, are higher than the costs for service in the rest of the country. Support for high cost exchange companies solves only part of this problem.

The FCC's "rate integration" policy has brought interstate toll rates for offshore areas into line with those that other Americans pay.

Residents of offshore points—especially Alaskans in remote villages that can be reached only be air or water—depend heavily on affordable long distance services for basic needs such as health care, supplies and contact with the rest of the state and the nation.

Without a safeguard, deaveraging appears inevitable and will push long distance rates for these very high cost areas to unreasonable and unaffordable levels.

The solution

This amendment:

Adds to the Universal Service Schedule the costs for offshore basic interLATA service that exceed 110% of the nationwide average costs for comparable service. The cost to the nationwide pool will be small: For example, the NTIA estimated that the total cost for supporting affordable service for Alaska would require a surcharge less than one-tenth of one cent per originating and terminating minute of intercity traffic. A substantial proportion of this total Alaskan support is already provided through the local exchange Universal Service Schedule in S. ——.

Defines exchanges as LATAs for the offshore points, which have not been involved in the divestiture proceedings because no BOC serves them.

Defines the basic toll service to be kept at affordable levels and the domestic offshore points involved.

Senator GORTON. Thank you, Mr. Gleason.

Mr. Erickson?

Mr. ERICKSON. Senator Gorton, my name is Jon Erickson, and I am general manager of Peninsula Telecom. I appreciate the opportunity to testify at today's hearing.

My comments are on behalf of my company which is a small independent telephone company serving 3,850 customers on the Olympic Peninsula of the State of Washington. In the past our company has consistently opposed the FCC access charge decision, and we continue to oppose it. We support current legislative proposals which would reverse the FCC's access charge decision.

And from recent awareness that has been shown by our customers, we know they also support similar legislation. We believe the FCC access charge plan is inequitable to residential and small business customers. It will impact particularly hard on rural America. Implementation of the FCC access charge plan could well be the beginning of the silencing of rural America.

The FCC and other proponents of the access charge plan emphasize in their propaganda that customers will only pay $2 for access in 1984. They do not talk about the possible impact in 1989 and beyond. They label estimates of the possible full impact on the consumer in 1989 as alarmist and not worthy of consideration.

To dwell only on the $2 access charge is laying a smokescreen, in my opinion, before the public, in hiding the possible drastic rate increases customers may be burdened with by 1989. We have reason to believe that our one-party residential rate could increase from today's $8.74 per month to as high as $25 per month by 1989. Now, that is a 190-percent increase.

I would say and note here that in your opening comments, Senator, you commented on the study made by the WUTC and other people have also commented on it. I believe those estimates are understated, at least for our company, by as much as 66 percent if you compare it with our current one-party rate.

Now, that increase is exclusive, that 190 percent, of inflation and any further future network access line increases. If inflation were considered at 5 percent, that same one-party rate could increase to over $27 a month, or 214 percent by 1989. The percentage increase for some Washington State companies could range higher than 300 percent.

I think that rate increases of that magnitude could well destroy universal service, and it could cause people to drop off the network.

In my written testimony, I cite the experience of our company and two other independents which suggests there is a strong correlation between telephone rate increases and customer dropoff. As customers drop off the network, the remaining customer base must make up the lost revenue through increased monthly rates. Theoretically, as more customers drop off, the higher local rates must go, more customers drop off. It is what is called a death spiral if carried out to its most extreme conclusion.

For our company, if 5 percent of our customers dropped off the network, it would reduce our annual revenues by over $63,000. That $63,000 would have to be picked up by the remaining customer base. If 15 percent of our customers dropped off the network, it would reduce our gross annual revenues by almost $190,000.

The FCC and other proponents of access charges lead the public to believe that competition will drive long-distance rates down and thereby offset rate increases caused by access charges. Now, I would be the first to concede that competition probably will bring some long distance rates down. However, the benefits will be primarily for the high volume toll users and not for the largest percentage of residential and small business customers.

Studies cited in my written testimony indicate over 50 percent of residential customers have an average monthly billing for interstate use of $2 or less per month while 43 percent of business customers make $2 or less in interstate calls per month.

When considering those statistics, it would take a 50-percent reduction in interstate toll rates to save 50 percent of residential customers $1. That $1 savings, if it actually occurs, is miniscule, in my opinion, compared with a possible interstate access charge of over $6 in 1989.

I think consideration must also be given to the possibility of toll rate deaveraging. Many industry people believe competition will cause toll rates to be deaveraged. If they are, toll routes that serve small communities will get hit with long-distance rate increases, not decreases. When toll rates are deaveraged, the residential and small business consumer will not only be forced to inequitably pay for long-distance access, but will also pay higher long-distance rates.

Once again, the high volume toll users will benefit at the expense of the residential and the small business customer.

My comments today have been on behalf of Peninsula Telecom. However, I believe they represent the opinion of close to 80 percent

of the independent telephone companies in the State of Washington. We believe that universal service can be preserved if Congress will act. We support Senator Packwood's bill, and we urge that the Senate proceed with a sense of urgency to pass legislation before January 1.

[The statement follows:]

STATEMENT OF JON C. ERICKSON, VICE PRESIDENT AND GENERAL MANAGER, PENINSULA TELECOM

My name is Jon Erickson. I am General Manager of Peninsula Telecom. Peninsula Teleco is a small, independent telephone company serving the western half of Clallam and Jefferson Counties. Our operating territory encompasses approximately 2,000 square miles. We serve approximately 3,850 customers from five (5) exchanges located in the communities of Forks, Clallam Bay/Sekiu, Neah Bay, Beaver, and Clearwater. Our operating territory can be characterized as rural, rugged and remote. Telephone communications are extremely important to our customers for economic, social and public walfare reasons.

The effects of recent FCC decisions and the split of the Bell System will significantly affect our customers, as it will all of rural America. As a small, independent telephone company, we are extremely concerned about the impact of deregulation on our customers. We are concerned that the FCC access charge decision and possible implementation of a state access charge system could well make basic service unaffordable to some of our customers. We are concerned that the FCC access charge decision could threaten the availability of universal service to many American households. We believe universal service has been an important national policy and it should continue to be a viable and important national policy goal in the future. Unfortunately, the FCC access charge decision threatens that national policy goal.

Peninsula Telecom has consistently opposed the FCC Access Charge decision, and we continue to oppose it. We support legislation which would reverse the FCC Access Charge Plan. As deregulation unfolds, we see it as a strategy of well organized, well financed and politically powerful large companies to gain economic advantages at the expense of smaller residential and business consumers.

ACCESS CHARGES

Peninsula Telecom believes the FCC access charge mandate is inequitable in that it places the full cost of "access" to the long distance network on the end user. We maintain that a system of access charges which places a reasonable share of the cost of maintaining the local phone system on all long distance companies to be more equitable. Without the benefit of the local loop, long distance carriers cannot provide their customers access to virtually everyone in America. By requiring all long distance carriers to pay for access to local telephone line, they will assist in keeping local rates affordable and preserve universal service.

We would ask, "Why should all customers pay for access to the long distance network when, in fact, a large number of residential and business customers never or seldom use the long distance network?" A study [1] (see Exhibit A) completed by a telephone industry task force indicates that 15.5 percent of residential users and 14.1 percent of business users make no interstate long distance calls during an average month. Moreover, 50.7 percent of residential customers have an average monthly billing for interstate long distance of $2 or less in an average month. Likewise, 42.6 percent of business customers make $2 or less in interstate long distance calls in an average month. Looking at long distance usage another way by examining the percentage of total long distance revenues versus the percentage of total customers, we find only 16.1 percent of residential customers place 64.3 percent of total interstate long distance residential billing, while only 12.8 percent of business customers place 84.6 percent of the total interstate long distance business billing.

Peninsula Telecom recently made a study of customers' long distance usage. We found 9 percent of our small business users made no long distance calls and 5 percent of our residential customers made no long distance calls at all during an average billing month. Furthermore, we found that 19 percent of business and residential customers made $6 or less per month in long distance calls. (See Exhibit B.)

[1] The Dilemma of Telecommunications Policy," a preliminary inquiry into the state of domestic telecommunications by a telecommunications industry task force.

It is clear to Peninsula Telecom that a significant percentage of residential and business customers place few, if any, long distance calls. We would ask, why should all customers pay for access to the long distance network when, in fact, a large number of residential and business customers never or seldom use the long distance network? Is an access charge system as mandated by the FCC equitable to the majority of residential and business telephone consumers?

In the continuing debate on access charges, proponents of access charges point out that competition will drive long distance rates down and thereby ameliorate the impact of access charge rate increases. We disagree. When so few residential and business customers use interstate long distance service, how will even a large decrease in interstate rates balance the expected access charge increases? The answer, we believe, is obvious—it won't.

TOLL DE-AVERAGING

Consideration also must be given to the impact of intrastate toll rates. Many industry observers believe that state toll rates will be "de-averaged". If state toll rates are de-averaged, it is fair to assume that many short haul toll routes serving rural areas will realize long distance rate increases, not decreases. This is true because toll routes in rural areas are generally lower volume, higher cost routes than those routes between larger cities and suburbia. When and if toll rates are de-averaged, the residential and small business consumer will not only be forced to inequitably pay for long distance access but also will pay higher long distance rates.

ESTIMATED ACCESS CHARGES

Peninsula Telecom has made estimates of how much its customers' local rates could increase due to the FCC's Access Charge decision, and estimates also have been made for all Washington State telephone companies. We have reason to believe our one-party residential rate for rotary service could increase from $8.74 to as high as $25.30 by 1989. That's a 190 percent increase. That increase is exclusive of inflation and any network access line increases. If inflation were considered at 5 percent, the Peninusla Telecom one-party residential rate could increase by 214 percent by 1989. The percentage increases for other Washington telephone companies could range higher than 300 percent. (See Exhibit C.)

DEMAND ELASTICITY

There is disagreement on the effect of significant rate increases on the demand for telephone service. Regardless of this, there have been demand elasticity studies made. Lester d. Taylor, in his book [2], reviews eight demand elasticity studies conducted between 1971 and 1978. The most quoted of all demand elasticity studies made is that of Dr. Lewis J. Perl, Vice President, National Economic Research Associated, Inc.[3] Dr. Perl found that the demand for basic service is significantly influenced by both the monthly service charge and the service connection charge. Furthermore, Dr. Perl found price elasticity of demand is quite sensitive to the level of household income and to the age of household. Moreover, Dr. Perl found that regardless of the demographic group considered, the biggest impact on price increase of telephone service is on the young, black, and rural demographic sub-groups.

Reviewing the demand elasticity studies must lead one to the conclusion that the demand for telephone service is highly price inelastic. If this assumption is accepted, then there should be genuine concern for the survivability of universal service in the FCC access charge environment.

During the last 3½ years, Peninsula Telecom has lost 6.7 percent of its network access line customers. Because of economic conditions in our area, we initially believed the customer loss was due to people moving from the area to look for work elsewhere. Recently, we began an onging analysis (Exhibit D) of the reasons why customers were disconnecting from our system. The results of that analysis were eye opening to us. During a four (4) month period (April 1, 1983 to August 1, 1983), 171 customers disconnected from our network. Of that total, 86 customers—or 50 percent—disconnected and moved from the area, 40 customers—or 24 percent—were disconnected for non-payment of delinquent accounts, and 45 customers—or 26 percent—voluntarily disconnected but continued to live in our operating territory. We

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[2] Lester D. Taylor, "Telecommunications Demand: A Survey and Critique" (Ballinger Publishing Company, 1980).

[3] Dr. Lewis J. Perl, "Economic and Demographic Determinants of Residential Demand for Basic Telephone Service" (National Economic Research Association, Inc., March 28, 1978).

believe the fact that 26 percent of all customers who disconnected did so voluntarily is good evidence they did so because price of telephone service versus discretionary income was a deciding factor. We believe this phenomenon (voluntary disconnect) could well repeat itself when significant rate increases occur because of access charges.

It should be pointed out that on August 1, 1982, a general rate increase was put into effect as approved by the Washington Utilities and Transportation Commission. That rate increase was an average 52 percent. The rate increase could have affected the decision for voluntary disconnects. Another rate increase of 32½ percent was effective August 1, 1983. We are continuing our survey of disconnecting customers to determine if the voluntary disconnect trend continues.

There are other documented cases which suggest a strong correlation between telephone rate increases and customer drop-off. One such case is that of Hickory Telephone Company, described in testimony presented before the House Telecommunications Subcommittee on March 22, 1983. Hickory raised is local rates in 1975 from $10.66 to $16.35, a 54 percent increase. Consequently, 14 percent of the customers discontinued their basic telephone service.[4] In another case, the Big Run Telephone Company in Pennsylvania requested and received approval for a substantial local rate increase to cover the costs of purchasing some used switching equipment. Approved in April, 1981, the new rate was an increase of about 40 percent, to a total of $21.75. Within several months, 22 percent, or 204 of the system's 924 subscribers, dropped service.

Peninsula Telecom believes that demand elasticity studies and the experience of our company, Hickory Telephone and Big Run Telephone are evidence that the FCC Access Charge Plan could well be the beginning of the silencing of rural America.

LEGISLATION

Peninsula Telecom supports legislation to preserve Universal Service. Universal Service can be preserved if Congress will act. A good start would be to reverse or stay the FCC Access Charge System. Peninsula Telecom believes the following principles should guide national telecommunications policy: "(1) all providers of telecommunications services, including bypassers of local facilities, should contribute equitably to the costs of providing local telephone service; (2) a Universal Service Fund to deal adequately with telephone service in high cost areas must be developed; (3) consistent and uniform regulatory policies between federal and state jurisdictions should be implemented; (4) end users should not pay directly for the costs of the local telephone lines; and (5) toll connecting links whose costs are significantly higher than the national average should be compensated for by the Universal Service Fund."

We urge the Senate to pass legislation which embodies the above principles and to work cooperatively with the House to approve legislation which will give clear direction to national telecommunications policy.

EXHIBIT A

(Excerpt from "The Dilemma of Telecommunications Policy," and preliminary inquiry into the state of domestic telecommunications by a telecommunications industry task force.)

EXHIBIT 8

TABLE 4.—DISTRIBUTION OF INTERSTATE LONG-DISTANCE BUSINESS BILLING

Average monthly billing	Percent of total—		Cumulative percent of revenues
	Customers	Revenues	
0.00	14.1	.0	.0
2.00	28.5	.6	.6
4.00	10.8	.8	1.4
7.00	8.7	1.2	2.5
10.00	5.3	1.1	3.7

[4] Testimony of Michigan Public Service Commission, Chairman Eric J. Schneidewind before the House Subcommittee on Telecommunication, Consumer Protection and Finance of the Energy and Commerce Committee, March 22, 1983.

TABLE 4.—DISTRIBUTION OF INTERSTATE LONG-DISTANCE BUSINESS BILLING—Continued

Average monthly billing	Percent of total—		Cumulative percent of revenues
	Customers	Revenues	
15.00	6.1	1.9	5.6
20.00	3.7	1.7	7.2
30.00	4.7	2.9	10.2
50.00	5.3	5.2	15.4
100.00	5.2	9.4	24.8
200.00	3.7	13.5	38.3
200.00+	3.9	61.7	100.0

Mean = $39.31
Excludes Centrex customers and Federal Government.

EXHIBIT 8

TABLE 5.—DISTRIBUTION OF INTERSTATE LONG-DISTANCE RESIDENTIAL BILLING

Average monthly billing	Percent of total—		Cumulative percent of revenues
	Customers	Revenues	
0.00	15.5	.0	.0
0.50	13.8	.6	.6
1.00	9.2	1.3	1.9
2.00	12.2	3.3	5.2
3.00	8.1	3.7	8.9
4.00	6.2	4.0	12.8
5.00	4.6	3.9	16.7
7.50	8.6	9.8	26.5
10.00	5.7	9.2	35.7
15.00	6.5	14.8	50.5
25.00	5.6	19.6	70.1
25.00+	4.0	29.9	100.0

Mean = $5.39

EXHIBIT B

MONTHLY BILLING

Toll usage	Business	Residence
$0.00	9	5
$0.00 to $2.00	3	5
$2.00 to $4.00	6	6
$4.00 to $6.00	1	3
$6.00 to $8.00	1	6
$8.00 to $10.00	1	2
$10.00 to $15.00	1	16
$15.00 to $25.00	10	16
$25.00 to $50.00	19	20
$50.00 to $100.00	29	13
$100.00 to $200.00	13	7
$200.00+	7	1

EXHIBIT C

	Peninsula	St. John	Tenino	Toledo	Lewis River	PNB/WA
1984:						
1 FR	8.74	6.00	6.00	6.00	5.00	11.15
Fed CALC	2.00	2.00	2.00	2.00	2.00	2.00
State CALC	2.61	3.78	3.34	3.89	2.62	1.47
Cost of access	13.35	11.78	11.34	11.89	9.62	14.62
Percent	53	96	89	98	92	31
1989:						
1 FR	8.74	6.00	6.00	6.00	5.00	11.15
Fed CALC	6.06	6.72	6.13	6.49	7.83	4.02
State CALC	4.72	5.36	5.21	5.70	5.58	2.26
Res to local	5.78	4.58	6.19	6.64	8.02	
Total	25.30	22.66	23.53	24.83	26.43	17.43
Percent	190	278	292	314	429	56
1984:						
1 FR	8.74	6.00	6.00	6.00	5.00	11.15
Fed CALC	2.00	2.00	2.00	2.00	2.00	2.00
State CALC	2.61	3.78	3.34	3.89	2.62	1.47
Cost of access	13.35	11.78	11.34	11.89	9.62	14.62
Percent	53	96	89	98	92	31
1989:						
1 FR	9.18	7.64	7.64	7.64	6.37	14.21
Fed CALC	6.06	6.06	6.13	6.49	7.83	4.02
State CALC	4.72	4.72	5.21	5.70	5.58	2.26
Res to local	7.44	5.84	7.89	8.46	10.22	
Total	27.40	24.26	26.87	28.29	30.00	20.49
Percent	214	304	348	372	500	84

EXHIBIT D

A survey of network access line customers disconnecting from Peninsula Telecom services. Study period April 1, 1983, through July 31, 1983.

Reason for disconnect	Percent	Number of access line customers disconnecting
Voluntary—stay in area	26	45
Voluntary—left area	50	86
Nonpayment	24	40
Total	100	171

Senator GORTON. Thank you, Mr. Erickson.

Mr. Appelo.

Mr. APPELO. Good morning, Senator Gorton and your friend from Kansas there, Ward White. I worked with him on telephone legislation for many years.

My name is Carlton Appelo. I have served as general manager of Western Wahkiakum County Telephone Co., for the past 31 years. I

presently serve on the board of directors of USITA and the National REA Telephone Association, and was the national president of OPASTCO in 1979. But today my testimony is only for myself and the subscribers of our company located here in southwest Washington. I sincerely believe that my opinions are closely in line with others serving rural and small town America. I have been working on national legislation since 1972, to try to get something passed that would be helpful to us in rural America.

Senator Gorton, I am most grateful for the concern shown by you and your committee in analyzing the possible adverse effects of the Federal Communications Commission's orders and directives on telecommunications in America. Most of the media coverage has concentrated on the breakup of A.T. & T. It is general knowledge that the Bell System companies serve 80 percent of the telephones in the United States, while we smaller, non-Bell companies serve about 70 percent of the geography of America.

The company and the territory that I serve certainly qualifies as rural. Our two exchanges at Grays River and Naselle serve 825 main telephones and a population of 2,000 plus. We cover an area 10 miles by 40 miles, requiring a relatively high investment. We have borrowed nearly $2 million from the REA during the past 15 years to bring modern dial service to our customers, and we are putting in a digital switch this year.

This equates to $2,900 per main station. Bell's national density is about 88 per mile, and ours is 4.8 per route mile of outside plant; 79 percent of our revenue comes from toll, and it is going to be extremely difficult when this source dries up, to be replaced by a burden on 825 customers, no matter what they are charged.

We feel that this ultimately will put us in default on our obligations to the REA, and we are not the only ones. There are 940 other REA borrowers owing some $4 billion to the Government. It is a concern to us and to them.

I also feel reasonably qualified to discuss telecommunications in the rural sector because, like many, I grew up in the business. I started at age 10 working on switching a local farmer's line in my father's general store and post office at Deep River. Except for 3 years in the Army and 7 years in college, I have been involved in the business ever since.

I feel I understand the need for reliable service at affordable rates in my community and have a strong sense of responsibility to continue that service to my neighbors. We are a locally owned stock corporation, owned by our customers primarily. There seems to be a strong agreement that if current FCC decisions are allowed to stand, the price of residential telephone service, particularly in rural areas, will skyrocket. Estimates range from a doubling of rates to a redoubling in a 3 to 4 year period. It has been argued, and with some justification, that telephone service has been so good, so cheap, for so long, that it would still be a bargain at twice the price. I am satisfied, however, that even a bargain can be priced out of the market in rural areas, such as ours, where cash income is very limited. What others may consider to be an insignificant amount can really make or break a rural budget.

We have no rich wheat farmers in our area. Fishing is a basket case, while it once was the primary industry. The local logging is

suffering severely with the departure of Weyerhaeuser's 194-man payroll in a region with a labor force of under 1,000.

Because of our rural lifestyle, living off the land, with a relatively small cash income has been adequate. However, there is a definite and rising requirement for funds to meet fuel costs, taxes, health care, electricity, and now telecommunications services. It is going to be a real challenge to make ends meet.

A national cost accounting firm study last month, in 22 States among a million customers, indicated that 7.5 percent never made any toll calls, 36 percent never made interstate calls, 12.8 percent made no intrastate toll calls.

Now, we did a study in our own area this month; 15 percent of our residential customers had no interstate toll, and 12 percent had less than $2. This is a total of 27 percent under $2. A small business study indicated that 36 percent of our business customers had no interstate toll, and 17 percent had less than $2. Hence, 53 percent of our business customers had less than $2 a month toll. This compares to our friend George Walker of PNB who testified recently that Pacific NW bills average toll is $22 per phone. This is not typical in rural Washington State.

Now, the FCC and some State commissions propose to assess an access charge to these customers who never use the toll network. It is my studied opinion that universal telephone service, once mandated by Congress, will simply disappear if the proposed access charge is levied on each end user, plus the inevitable local service rate increases generated from normal inflationary pressures.

In our own case, we have had a net operating loss for the past two quarters. We will need a rate increase just on economic need, in addition to the prospective access charge in 1989, of $18.29 per month.

The FCC and other regulators have contended, supported by the new long distance carriers, that local service rates are unreasonably low because of the toll subsidy. I grant that compensation paid to the local systems for the use of their facilities to complete toll calls is a major contributing factor to the financial health of these local companies, so much so, that many companies will not survive without it. However, this settlement process was worked out within the industry and in conjunction with the FCC. It has long been considered fair and equitable by the industry, by the regulators, and the general public. The joint use of local facilities funded by an additive on toll rates has made possible universal service at affordable rates such as Congress dictated back in 1934. It has worked well for the benefit of all concerned, enhancing the ultimate goal of a phone in every household, farm, and small business in America.

Why should this compensation procedure now be discontinued? The bypass bugaboo is addressed in S. 1660.

There is a second gut issue looming on the horizon of rural America, a proposal that long-distance charges be deaveraged, allowing the low usage, low density routes to carry their true cost burden. Benefits would accrue to the competitive high usage routes, Seattle-Chicago, Los Angeles-New York, but like the airline experience, our Grays River-to-Seattle or Tenino-to-Portland rates would rise like a cat's back. Surely it would eliminate all, save absolutely emergency calling between rural and small community

points. How could any small business survive and prosper in this environment?

We need a carefully crafted legislative proposal to address this point if we want the infrastructure of rural America to survive.

In summary, I urge Congress to readdress its original mandate of universal service at affordable rates to urban and rural customers across the land. To accomplish that goal, I believe it is essential that specialized carriers continue compensating local carriers for the joint use of local facilities needed to complete a long-distance call. A practical system of separation of costs is in place and working. A surcharge levied equally upon all toll calls will not threaten the new competitive market and it does permit the continuation of a remarkable, complete, and excellent level of telephone service for the entire Nation. It would also avoid silencing a substantial element of residential America.

I thank you very much for your attention and I will be glad to answer any questions about our company or any other items.

Senator GORTON. Thank you, Mr. Appelo.

I think I will ask the first question to both Mr. King and Mr. Erickson. That question is whether or not this panel correctly reflects the differences of opinion on this subject among independent telephone companies. I believe Mr. Erickson stated that 80 percent of the companies are against the FCC decision, which would imply that 20 percent do not want it changed.

Is that correct? If so, what percentage of the actual telephone subscribers in WITA are represented by that 80 percent and what by the 20 percent of those two of you who came out on the other side on this issue?

Mr. KING. Mr. Erickson used that statistic. I will let him answer.

Mr. ERICKSON. Well, my reference to 80 percent, Senator, is from the fact that of the 25-member companies in our State association, or 24-member companies, 4 of the companies are larger holding companies, and in my discussions with people like Mr. King, I think it is fair to say that they are against reversing the FCC access charge decision, and therefore, against the legislation. However, the small companies like Carl Appelo and myself generally agree that we would like to see it reversed.

Now, as to the percentage of customers represented by that 80 percent, I don't have that statistic.

Senator GORTON. It would, I take it, be somewhat closer to even.

Mr. ERICKSON. No; it would not. It would be much, much less than even because when you take General Telephone Co. and United and Pacific Telecom, they serve a large number of customers.

Senator GORTON. Very well. So you have about 70–30 in reverse.

Mr. APPELO. Senator, I think that one must vote his own interests. Larger companies certainly have a stake in the interconnect market themselves, and I think you know the significance of this factor. A large corporation must be able to develop an economic plan. They require a situation that is stable. The way things are moving it is very difficult to plan next year's budget in a period of fundamental change. They must seek stable factors to anchor their long-range plans.

So I do not disagree with their stand but I disagree with their method of securing stability.

Senator GORTON. Mr. Gleason, I have a very specific question for you. Are there other companies providing long-distance services in Alaska besides Alascom?

Mr. GLEASON. Yes; there is one company serving Anchorage, Alaska only, the only city with any major market, representing about half the population of the State.

Senator GORTON. Is that company eligible for assistance under the language that you have proposed?

Mr. GLEASON. I would believe not because they do not provide universal service to the State of Alaska. We are attempting to provide service to the entire State, not to the principal market.

Senator GORTON. Now, my next question is more general and any of you who like may answer it.

After the full transition under the access charge decision, considering the receipt of funds from the universal service fund, what percentage of your customers do you predict will drop telephone service because of the higher rates?

If we went ahead, no legislation, no changes in the access charge decision, what will happen?

Mr. GLEASON. I would address that. Where our rates would be expected to go from $6 to $16 over a 6-year period, we would not expect to lose a measurable percentage at all, particularly if we were able to provide an optional measured service that would be a low-cost service with limited calling to meet the needs of the universal service.

Senator GORTON. Mr. Erickson?

Mr. ERICKSON. Senator, I cite in my testimony that we have made a 4-month study of customers who have dropped off our network, and we believe there is some correlation between that and rate increases. On August 1, 1982 we had approximately a 52-percent increase in our local rates, which was approved by the State commission. We initially thought that all of the people that were dropping off our network were doing so because of the poor economy we had because of the wood products industry. However, the study that we made showed that almost 26 percent of the customers during that 4-month period that we surveyed dropped off the network voluntarily but stayed in the Forks and vicinity area. We are continuing that survey, and although we have not completed it yet, indications are that we are continuing to lose customers voluntarily, and they are staying in the area.

So we believe there is a relationship. Approximately 1.2 percent of the customers that dropped off did so voluntarily and stayed in our area.

Senator GORTON. Do you expect to lose 10 percent, or more than 10 percent if this plan were fully implemented by 1989?

Mr. ERICKSON. Well, I do not know if I would expect to lose 10 percent. The Perl study has been cited, and there is a lot of disagreement, as Mr. Walker indicated, as to whether that is a valid study; but I would say, based on our experience, that we maybe could expect to lose 6 to 10 percent.

Senator GORTON. Mr. Appelo, would your answer be any different than that?

Mr. APPELO. Well, when I was a boy we had 26 people on our farmer line, and we got along because people were considerate in sharing the facility. And I think this condition could return. As the rates go up, a neighborhood group will drop out. One family will retain a telephone, and will share the use and costs of that phone with two or three neighbors. I think Ward knows Bob Bolden in Kansas. He has a cable TV and a telephone company. Even at a $4.25 monthly telephone rate, he is having people drop off because they now feel the economic tightening of rural America. The problem we have is a lack of adequate cash income in a rural area. They get along by substituting barter and growing their own food crop. When you start raising telephone rates, it really hurts a rural area.

Senator GORTON. Should Congress insure that rural local rates are lower than the local rates in urban areas? Should your basic rate be lower than the rate in Seattle?

Mr. APPELO. Well, I guess it is a question of how much value the telephone is to you. In a large urban area you have access to 500,000 to 750,000 phones included in your basic monthly local service charge. Your rates should be higher than our rural rates where you reach only 825 phones toll free. Even in our county, now, we have three systems. The county seat is a toll call, and our hospital and our doctors and pharmacy are toll calls. There has to be some disparity between urban and rural rates on the basis of use available to each type of customer without paying additional charges.

Senator GORTON. Now let's make the opposite assumption that I made for my first question, and that is that some bill of the type which are now before Congress will pass.

We have had some testimony that under those circumstances, subsidizing local telephone companies that serve high cost areas will encourage inefficiency.

Do you agree? If rates are subsidized at some percentage of cost above the national average, will that encourage a lack of innovative or new technology?

Mr. KING. In my personal opinion, it depends on the level of that subsidy. If the covering, let's say, 100 percent of the costs above X, then your incentive to try and reduce your costs just becomes less than if there is some kind of an incentive system that would encourage you to.

Senator GORTON. Then you could say that if there is going to be a subsidy system, at no point should it be 100 percent.

Mr. KING. That would be my personal opinion, Senator.

Senator GORTON. Mr. Erickson?

Mr. ERICKSON. Senator, I think that a subsidy system like that could in fact promote inefficiency, but I think that with proper State regulatory oversight, that those inefficiencies can be taken care of. I think that we have learned a lesson in our company in the last 3 years, and that is that we have had to take a very close look at where we are inefficient, and we have made a lot of cutbacks. So I don't think that we necessarily need a 100-percent subsidy.

Senator GORTON. How could Congress insure that any money that you received, either from long distance carriers or a universal service fund, would go to keeping local rates down?

Mr. ERICKSON. Again, by regulatory oversight.

Mr. APPELO. Senator Gorton, when you live in a small rural community and everyone knows you and you know everyone else, you don't really need the FCC or WUTC to regulate you. Your neighbors do that function. Certainly for financial and technical reasons it is helpful to have professional regulation. In our case we are installing a digital switch at a considerable cost, but our expenses on the old mechanical switch were running more than $30,000 a year maintenance. We just could not live with this growing expense. We had to replace the worn out step switcher with a minimum size digital switch for economic reasons. It may have only 500 lines equipped, but you still must have all the bays, CPU, and common equipment needed to make the switch work. It will serve our community as long as the technology lasts. Who knows how long that will be. Rural America needs the same quality of service as urban customers. They need access to the information age like anyone else. We must find a way to give rural America that same access to the information age that urban America enjoys.

Senator GORTON. Again, I would like to thank this panel for its helpful and enlightening testimony.

Mr. Jasper, Mr. Tuttle, Mr. Horley, and Mr. Ayres.

We will start with Mr. Jasper.

STATEMENTS OF HERBERT N. JASPER, EXECUTIVE VICE PRESIDENT, AMERICAN COUNCIL FOR COMPETITIVE TELECOMMUNICATIONS; F. THOMAS TUTTLE, VICE PRESIDENT, REGULATORY AND INDUSTRY RELATIONS COUNSEL, SATELLITE BUSINESS SYSTEMS; AL HORLEY, VITALINK COMMUNICATIONS CORP.; AND M. U. AYRES, GENERAL MANAGER, NETWORK SERVICES, BOEING COMPUTER SERVICES

Mr. JASPER. Thank you very much, Mr. Chairman.

The competitive long-distance carriers which our association represents appreciate the opportunity to testify on S. 1660 and related bills.

For many years telephone companies and most State utility commissions enjoyed a sort of marriage of convenience. The telephone companies followed the extraordinary practice of capitalizing, rather than expensing, labor costs for installing telephone equipment. They also used unbelievably long depreciation schedules for amortizing facilities and equipment. Thus, they inflated their rate bases and therefore, their profits.

The utility commissions went along with these dubious practices because they restrained the need for rate increases in the short run. The commissions held down rates of return in the face of skyrocketing interest rates, and they did not provide sufficient allowance for inflation. The States were seemingly unconcerned about the long-run implications of these actions.

Well, the chickens are now coming home to roost! That is why we are seeing rate increase requests in the 50-percent to almost the

200-percent range. These rate requests, however, have very little to do with actions of the FCC or the Federal District Court.

What are the State commissions proposing to do about all of this? With a few notable exceptions, such as that of your Washington commission, they are crying for help, not from their State legislatures, but from the U.S. Congress. They have riveted the Congress attention on the FCC's initial $2 per month customers' access charge to be effective next January. That would add about 15 percent to the local exchange portion of the average telephone bill. But that charge would be more than offset by the savings on terminal equipment lease charges, at least a dollar a month per customer, and long distance charges, about $2.70 per month per customer, on average. While the subscriber's access charge would rise over a 6-year period, so would the savings on long distance.

The commissions are complaining principally about a long distance access charge because a few subscribers neither make nor receive long-distance calls, but these very same commissions have, without any prodding from Washington, often imposed an entirely analogous system charge on gas and electric customers which is collected even if the householder is away on vacation and no fuel is consumed.

In many States the commissions are continuing to block the introduction of competition in intrastate long distance, and they oppose legislation to rationalize the regulatory structure by consolidating long-distance jurisdiction in the FCC. In addition, they are pressing for delegation to them of existing Federal power over access charges for long-distance companies. They seek to have Congress revoke the FCC's authority over depreciation rates for jointly used equipment.

Finally, they want a massive transfer of funds scheme in which telephone service would become the only utility for which the Federal Government would bear a responsibility to make rates nearly uniform throughout the States.

If the Congress does what many State commissions are asking, we can expect the following results: Modernization of exchange telephone company plants will be slowed, thus creating incentives for bypass. Residential long-distance users, including the poor, disadvantaged minorities, and the elderly, all of whom make disproportionately high numbers of long-distance calls, will be taxed to subsidize high cost telephone companies. Subsidies will drive up total communications costs because local companies will have their inefficiency or high profits underwritten by citizens of other States.

If the high cost companies do not misapply the subsidy funds to underprice their competitive ventures, they will then benefit rich and poor subscribers alike, as well as large and small businesses. Innovation will be slowed, thus hampering America's competitive posture, not only in communications, but in all industries making extensive use of communications.

The pressure for substantial rate increases will be substantially unaffected by such legislation, and the protection of universal service will not be strengthened the least bit.

Finally, years of uncertainty and litigation will ensue over the claim of an unconstitutional delegation of the Congress taxing power.

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What then should be done? First, the Congress should hold the State commissioners' feet to the fire. It should insist that they act responsibly and decisively on their rate cases.

Second, it should require regular reports from the FCC about the impact of all Federal and State actions, not only on the preservation of universal service, which of course is very important, but on the encouragement of efficient and economical telecommunications services, both local and long distance. In other words, I am supporting Commissioner Hall's statement that you should have progress reports on how the communications business is evolving in all its manifestations, not just price.

Third, if the Congress believes that immediate action is required, it should enact legislation assuring subsidized lifeline service limited to those subscribers who might not be able to afford higher rates, regardless of whether they live in high-cost or low-cost areas.

Thank you.

[The statement follows:]

STATEMENT OF HERBERT N. JASPER, EXECUTIVE VICE PRESIDENT, AMERICAN COUNCIL FOR COMPETITIVE TELECOMMUNICATIONS

IS THE SKY FALLING

Or are State utility commissions trying to dodge their responsibilities while seeking to increase their authority?

S. 1660 is one of more than a dozen House and Senate bills which have been introduced in response to a misperceived emergency involving very large local telephone rate increase requests which have been filed or are anticpated in many states. Most of these bills are ill-conceived, substantially misdirected and premature.

Fears have been expressed about doubled or tripled local rates and a threat to the maintenance of universal service if rates rise to unaffordable levels. Many in Congress and focusing attention on the small fraction of these pending or anticipated rate increase requests which relates to actions of the Federal Communications Commission (FCC), principally faster depreciation and the gradual transfer of the full cost of the local subscriber line to the subscriber.

While much of the pressure for precipitate Congressional action comes from state regulatory officials, it is ironic that these officials have had and will retain the principal power to control local rates. As discussed below, the state commissions have both the authority and the responsibility to disallow substantial portions of the very significant elements of costs which are involved in pending or expected rate requests if they are unjustified.

Recently, two state commissions have denied the requested increases entirely and several have allowed as little as 25 percent of the proposed increases. And in Texas, where the largest rate increase is pending, Southwestern Bell has proposed to reduce its request substantially.

Many of the proposed bills evidently are based upon several false premises. Below are seven such false premises and seven corresponding propositions. (In the following pages, we explain why we and others believe that the Congress is proceeding on inadequate and faulty data and analysis. And we offer alternative methods for achieving the stated objectives of S. 1660 and the other bills.)

False premises	*Propositions*
1. In an increasingly competitive industry, total costs to be recovered from telephone users will not increase but will decline. Increases in local exchange rates will be offset by reductions in long distance and terminal equipment charges.	1. Competition and AT&T divestiture will cause telecommunications costs to rise, forcing local exchange costs to unaffordable levels for many subscribers.

2. State utility commissions can and will continue to disallow large portions of the pending or expected local rate increases requests; significant decreases in Bell Operating Company (BOC) costs in 1984 will offset a part of the anticipated requests for increases.	2. State commissions have insufficient power to keep local exchange rate increases to reasonable levels; therefore, such large increases will occur and substantial drop-off in telephone subscriptions will result.
3. The FCC's access charge, "Separations" reform, and depreciation decisions protect universal service, as does the Modification of Final Judgment in the AT&T case.	3. Several FCC decisions undermine the "universal service" objective of the 1934 Act and will require unreasonable increases in local exchange rates.
4. Universal service was not achieved through separations and settlements and division of revenues but chiefly through the Rural Telephone Act; any long distance subsidy which may have arisen under "Separations" was unintended and has typically been used to underprice competitive ventures rather than to keep local exchange rates low.	4. The elimination of a long distance "subsidy" to local exchange service is a reversal of long-standing policy and threatens the maintenance of universal service.
5. Universal service can be preserved by subsidies designed to assist only those who can not afford increased local telephone rates and they can be appropriately and lawfully funded without "taxing" long distance users.	5. Providing subsidies to high cost areas is a sound approach to maintaining universal service.
6. Competition in telecommunications is needed to prevent technological stagnation and produce economies for all, and such competition requires the introduction of cost-based pricing.	6. Taxing long distance users, including "by-passers", to subsidize local exchange subscribers can be accomplished without harming those same subscribers, repressing innovation in telecommunications, or making American industry less competitive in world markets.
7. There will be significant adverse economic and competitive effects on our nation's telecommunications if a comprehensive system of telephone rate subsidies is adopted.	7. An efficient and competitive market structure can be fostered while requiring some services to subsidize others.

DANGERS OF ILL-CONSIDERED LEGISLATION

The stakes are very high. Enactment of some of the pending legislation would: hobble the telecommunications industry which is one of America's last-remaining leaders in high technology; penalize efficient producers and reward inefficient producers; provide a blunderbuss approach to subsidies, indiscriminately helping the poor and the affluent, and small and large business, while taxing, among others, rural and poor groups, whose members typically make disproportionately large numbers of toll calls; relieve the state utility commissions of the need to deal responsibly with their present and anticipated rate cases while shielding them from the consequences of their past mistakes; give the state commissions additional authority over vital segments of interstate commerce for which (in the case of the vast majority of states) they are wholly unequipped: raise all telecommunications costs, including those for local rates, over the long run and inhibit new services; risk years of uncertainty while litigation proceeds over constitutional issues; and fail to deal meaningfully with the principal objective, that is the preservation of universal service.

What the Congress should do is slow down the "steam roller" and get the facts before acting, not afterward. There are methods of dealing responsibly with any threat to universal service which may arise—and there is ample time to do so. In particular, paying subsidies only to those who would actually find higher rates unaffordable, regardless of whether they are in high-cost or low-cost ares, would be a far

more effective means to preserve universal service. And funding such subsidies from alternative sources of revenues, such as the Rural Telephone Act or the existing telephone execise tax, would not impair the effective growth of our nation's telecommunications.

The FCC and the telecommunications industry—monopoly and competitive suppliers alike—are eager to help in identifying the problems and designing solutions. But they must first be heard.

With competition, total telecommunications costs will decline; reductions in long distance and equipment charges will offset increases in local rates.

In industry after industry, the development of effective competition, where there had been monopoly supply, has lowered prices on average, not raised them. This is because each competitor employs technological innovation and increased productivity to lower his costs in relation to other competitors in order to gain more business through lower prices to consumers.

There are bound to be short term price changes, both up and down, for particular parts of telephone service as the various markets adjust to competitive conditions. For example, local rates may rise as prices are cut in both intrastate and interstate long distance rates.

Leaving inflation aside, the only way overall telephone rates, including local rates, will not go down over the long run is if the Congress and regulators try to hamper the development of a competitive telecommunications market place. This is the likely outcome of any legislation which may be hastily passed before anyone is able to determine what, if any, social hardship is likely to arise under a rational market system.

Significant reductions are expected soon in interstate long distance rates. Not only have residential and business subscribers enjoyed for some years the savings offered by competitive long distance carriers, but cuts of up to 15 percent in AT&T's rates have been predicted for next year. The FCC Chairman forecast eventual cuts of 35 percent or more. Reductions in long distance rates will benefit, in many cases, the same subscribers whose local rates may go up since more than 50 percent of long distance revenues are derived from residential callers. And the subsidies proposed to be paid to local exchange companies pursuant to a number of pending bills would apparently not be limited to residential customers but would be enjoyed by business subscribers as well.

According to AT&T's Chairman, Charles Brown, the average monthly telephone bill is about $37, of which more than half is long distance. Thus, a 15 percent reduction in that portion of the bill would more than offset the initial $2 customers' access charge.

There is also to be considered the substantial savings already experienced or in prospect through the purchase of terminal equipment. In many cases, consumers are able to buy telephones for less than one year's lease charges for comparable equipment under tariff. Moreover, competition has offered innovative terminal equipment and soft-ware which has enabled both large and small businesses to increase their efficiency, improve their productivity and decrease their long distance costs. Residential subscribers have, likewise, benefited by more flexible and convenient terminal equipment providing them opportunities to save time and money, as well as providing increased access to new information sources.

Factors cited by telephone companies in recent rate cases, or expected to be included in 1984 cases, include:

1. Cost-of-doing business, including higher prices, wages and taxes, and investment in new facilities.
2. Need for higher rate of return, i.e., profits.
3. Costs attributed to AT&T divestiture.
4. Loss of the alleged subsidy from intra-state and interstate long distance revenues.
5. Customers' access line charges (CALC).
6. More rapid depreciation of equipment.

The first two items are very significant elements in determining the costs, and therefore the rates, of telephone companies. The states' authority over these matters, including the approval and valuation of investments and the determination of the reasonableness of expenses, is undiminished.

As noted below, we believe the alleged long distance subsidies have not been demonstrated, have been grossly exaggerated, or have been applied to competitive lines of business. We have discussed the customers' access charges.

Rate changes will vary drastically from state to state, as they should since the various state commissions and telephone companies have followed different policies and practices in the past. For example, some companies have regularly invested in

new equipment while others are now trying to catch up in recognition of the needs of customers and the customers' ability to use alternative means of communication.

According to the analysis of pending or recent rate cases compiled by staff of the House Energy and Commerce Committee, some states have no local rate increases pending, some requested increases have been rejected in their entirety and other requests are as low as 13 percent. Among 1983 cases already decided, increases approved have been as low as 7.5 percent.

In 1982, according to a NARUC publication, about 50 rate requests (Bell and independent) were decided, with an approval percentage of less than 45 percent of the requests. In all 1983 cases cited in the Congressional staff analysis, increases granted have been less than one-half of the amount requested and several have been less than one-quarter of the requested amount.

The 1983 average in cases decided is about 37 percent of the amount requested. Thus, it appears that the percentage approved in relation to the amounts requested is declining.

Most pending cases involve rate increase requests in the one-third to two-third range. And Southwestern Bell has now proposed a substantial reduction in the largest (186 percent) pending increase. The record of cases in recent year in states where such large increases are pending suggests that the utility commissions are likely to grant, at most, only one-forth to one-third of the amounts requested. Indeed, AT&T's Chairman, Charles Brown, testified at the recent joint hearings that some of the requests appeared unjustified (including any parts attributed to divestiture) and that companies often ask for more than they expect to receive. He insists that local rates should not have to rise by more than 10 percent annually in the next five years.

A substantial portion of many requested increases is to cover the costs of more rapid depreciation of equipment. In the long run, this will save money for consumers, both by getting equipment out of the profit/earning rate-base sooner, and by helping to protect the local exchange against by-pass by upgrading its facilities to the needs of contemporary communications.

Another substantial part of the BOCs requested increases relates to higher profits. While a fair return on investment is needed to insure an up-to-date system, there is serious doubt as to the reasonableness of a number of pending requests for higher rates of return. We question whether the PUC's will agree that the companies' cost of capital is over 17 percent, as was claimed when one BOC requested to earn a profit which excees that allowed AT&T by the FCC by as much as 5¾ percentage points!

It is cause for concern that many of the bills would reduce the state commissions' incentives to disallow unreasonable costs. For example, a state commission might approve a high rate of return for a telephone company (especially if locally owned) knowing that long distance customers in another state would, in effect, be paying the high profits to the owners of the "high-cost" company.

Much attention has been focused on the increased charges to end-users in January 1984 under the FCC's access charge decision. There are, however, other changes in the industry's financial structure which will help offset those charges and other possible increases. For example, in 1984 the BOCs will stop making license contract payments to AT&T. Some of these savings will be used to finance the Central Staff Organization but it has been estimated that this may cost the BOCs as much as two-thirds less than their current payments to AT&T. Further, existing data show that the BOCs have been cross-subsidizing their sales of Western Electric equipment. Here, too, they should save money for their subscribers when they can buy, as well as sell, at competitive market rates. Finally, under cost-based access charges, it is expected that the BOCs will be reimbursed by AT&T for a variety of services now provided to it but for which it is not now charged.

According to the analysis of pending or recent rate cases compiled by staff of the House Energy and Commerce Committee, there are a number of states where intrastate long distance rate reductions—ranging from 3.3 percent to 30 percent—have been made or proposed. If these reductions are disapproved by the state commissions it should reduce the amount of any needed local exchange rate increases.

There is a strong possibility that proposed intrastate rate cuts represent an attempt by the BOCs to prepare for predatory pricing of their intrastate competitive services by improperly transferring revenue requirements to local exchange functions. This would artificially enlarge the amount of any cost-justified increases in local rates. So long as the Congress permits jurisdiction over long distance services to be scattered among the states, it has no power to assure that such anticompetitive practices will not occur.

FCC decisions and the modification of final judgment protect universal service.

The FCC's access charge ruling states its major goals in the Preamble: the continued assurance of universal service; the elimination of unjust discrimination or unlawful preferential rates; the encouragement of network efficiency; and the prevention of uneconomic bypass. Thus, the FCC, itself, lists universal service as its first and foremost goal.

To implement this goal, the Commission takes two important steps. First, it provides for a six-year transition period during which all costs of the dedicated local subscriber line are assigned to the local subscriber. The costs of this line are incurred whether or not the end-user makes or receives any calls, either local or long distance. They are the basic costs of connecting a telephone to the Central Office. The FCC's recent amendments to the order require interstate carriers to pick up a large share of these costs in 1984 and stretch out the period over which the full cost is shifted to the end-user, who caused the costs to be incurred and who has exclusive use of that line. This charge is directly analogous to the "system charge" which many state utility commissions have imposed on gas bills, a charge which the customer pays even in months when he is away and the gas is turned off.

Second, in replacing the existing Separations and Settlements and Division of Revenues processes with access charges, the FCC creates a "Universal Service Fund" which is specifically targeted toward high-cost telephone companies. This fund will be financed by the interstate carriers (who will, of course, include such costs in their charges to users of the interstate telephone system). Thus, under the FCC's plan, these interstate users will, in fact, subsidize local telephone rates where local costs exceed the national average by specified percentages. The universal service fund is a permanent mechanism under the FCC plan.

In his required changes in the MFJ in the AT&T case, and in the reorganization plan to carry it out, Judge Greene has also sought to insure that universal service is protected. First, he has required AT&T to provide the Bell Operating Companies (BOC's) sufficient resources and satisfactory debt-to-equity ratios so that they will be economically viable. Second, he has insisted on considerable flexibility for the BOC's to earn revenues from a variety of competitive services, such as marketing terminal equipment and Yellow Pages advertising.

Third, he has required that the Bell name and logo be reserved for the BOCs to strengthen their ability to market their services and customer premises equipment successfully. Finally, he has required that the BOCs be assigned all existing AT&T patent rights (and those obtained during the next five years) and that they be allowed to sublicense them to others so that they can develop new product lines and also be able to negotiate lower equipment purchase prices from the suppliers.

As discussed under Proposition No. 6, the FCC's depreciation decision is a means of protecting the local exchange companies and their customer-base by assuring that capital investments can be recovered in a reasonable number of years. Otherwise, the local exchange facilities can not be kept up to date, nor can they meet the needs of their large users who might, then, seek to by-pass the exchange.

Universal service not achieved by "separations" but by the Rural Telephone Act; any actual long distance subsidy was unintended and has not been used to keep local exchange rates low.

Contrary to widely-asserted claims, universal service did not result from long distance subsidies to local exchange rates through the "Separations and Settlements" and "Division of Revenues" processes. These are business mechanisms used to divide revenues for interstate service where facilities of more than one company are involved in providing the service.

The FCC has pointed out on numerous occasions over the years that these are allocations procedures which reflect the costs of each carrier and that legally "allocations cannot and should not be designed to artificially shift any part of the revenue requirement applicable to one jurisdiction into another." [1] That policy stems from the Supreme Court's 1930 decision, in *Smith* v. *Illinois Bell,* requiring costs of jointly-used plant to be allocated between local and long distance revenue requirements. That decision was intended to stop an unlawful subsidy from local subscribers to long distance users—certainly not to establish a subsidy in the opposite direction.

The current arrangements were established under the "Ozark Plan" in 1970. As then-Chairman Dean Burch has stated, they were not designed to provide any subsidy. Further, the objective of the State PUCs in proposing that plan was to gain additional revenues to eliminate the "toll-rate disparity" (which is the difference between high intrastate long distance rates and lower interstate rates).

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[1] Specialized common carrier decision, 31 FCC 2d 1108, released October 6, 1971.

It has never been demonstrated that any net flow of revenues from long distance to subsidize local exchange rates actually occurs. Judge Greene has several times stated in the AT&T antitrust case that the widely-accepted claim of a subsidy from long distance to local service has not been established. Assistant Attorney General Baxter has testified before Congress to the same effect.

According to analysis of the telephone industry's own data (as presented by Professor William Melody, a Government witness in the AT&T antitrust case) the transfers of revenue requirements under the Ozark Plan were misused. In the main, the BOCs diverted the revenues received to underwrite their competitive offerings, notably terminal equipment and intrastate private line, and did not use them either to equalize toll rates or to keep local exchange rates down.

The State commissions, which had gained their objectives in the Ozark Plan, failed to prevent such abuses. Thus, the revenue-sharing mechanisms were not developed out of any concern on the part of the FCC, the local telephone companies, AT&T's Long Lines, or to the state commissions for universal service or for high rural exchange costs. Yet many of the pending bills propose to replace tense revenue sharing mechanisms with new subsidies to high-cost telephone companies without any assurance that the utility commissions would require that the funds be applied to the intended beneficiaries. (Some of the bills would also vest the state commissions with substantially increased powers over vital elements of the industry—powers which in some states would likely be exercised in contravention of the pro-competitive polcies of the Congress and the FCC.)

There are additional factors which cast doubt as to the amount of any long distance subsidy to local telephone companies. First, the local companies provide many services to AT&T without charge (services which they do not provide to AT&T's long distance competitors). Second, they provide AT&T superior interconnections for which the cost-based rates have not yet been established. Third, they now pay AT&T large sums of money under the license contract agreements which must be terminated under the new consent decree. Finally, they will no longer have any incentive to purchase Western Electric equipment at inflated prices with the consequent revenue short-fall when that equipment is leased for less than fully compensatory rates.

As recently as 1950 telephone service was still furnished to only 32 percent of the nation's farmers. It was the enactment of the Rural Telephone Act in 1949 which gave the major impetus to extending telephone service to rural areas by making investment funds available at much lower interest rates (originally at 2 percent) for telephone companies in thinly-populated areas. Loan rates have risen recently to near 5 percent, but the average interest cost on rural telephone company loans is still well under 5 percent.

Members of Congress accept the estimated 96 percent level of service which we enjoy today as the achievement of "universal" telephone service. By the time the Ozark Plan first introduced the "Subscriber Plant Factor" (SPF) to the settlements process in 1971, telephone service had already reached almost 91 percent of American households. Thus, it is clear that universal service was made possible by the rural telephone program. Therefore, a more appropriate response to the perceived threat to universal service would seem to be extending or expanding that program as may be needed to meet any problems which might arise if costs go up unreasonably in high-cost rural areas. It should be noted that the existing program has helped to keep local rates in many rural areas substantially below those prevailing in urban areas.

Universal service can be preserved by subsidies targeted to those who can not afford increased local rates; they can be funded without "taxing" long-distance users.

If it should be determined that increased local rates will threaten universal telephone service, there are various methods available to preserve such service which are far more effective and much less destructive than those proposed in many of the pending bills. For instance, low cost service options already exist in some states. And there are methods which the Congress has traditionally employed to aid specific groups consuming services from a variety of different industries without distorting the economics or efficient operation of those industries.

A low-cost service option termed "lifeline," "basic," "economy," or "low usage" service is now available in a number of states. The typical lifeline service has an access charge (such as $2 to $6 per month) which is much lower than the regular flat rate service of, say, $8 to $15. It includes unlimited incoming calls. But the number of out-going calls included in the basic charge varies from none (with each call costing 3 cents to 10 cents) to a small number, such as 5 to 20 calls (plus 6 cents to 14 cents for each additional call.)

Local measured service (or LMS) is now offered in about 37 states. Many consumer groups have opposed this approach, contending that it unreasonably discourages necessary calls by low income persons and that it provides built-in revenue increases for telephone companies as calling volumes grow.

State utility commissions have the power, however, to require that LMS offer low-use subscribers a genuinely, low-cost rate schedule in which the basic service fee would be much lower than that for flat-rate service. If accompanied by a fair and reasonable schedule of charges for outgoing calls, such an offering might provide a useful alternative to lifeline service which would then be limited to low income subscribers.

Proposals to tax (or surcharge) long distance users are frequently couched in terms of making carriers pay their fair share of the subscribers' loop costs. But any charges to carriers will, of course, be passed on to their customers. And, since more than 50% of long distance revenues are generated by residential subscribers, the proposed bills would overcharge residential long distance users, including rural and low income groups whose members typically spend a higher-than-average portion of their incomes on toll calls. Since a large share of local exchange revenues is derived from business subscribers, the effect of most of the bills would be to have residential subscribers "subsidize" not only themselves, but also large and small businesses.

The arrangements for cost-sharing and fund transfers which exist in the industry today have been agreed to by the participants (except for some unwilling participants in ENFIA), with FCC approval. If such transfers do include a subsidy, this is an entirely different matter from an action by Congress to require a subsidy to be paid by one private group to another. Any charge imposed by government which exceeds the cost of the service rendered is, in fact, a tax.

The Congress, of course, has the power to tax the communications industry, as any other. But it should recognize that it is imposing a tax when it chooses to do so and it should then follow constitutional processes. Indeed, in justifying a universal service subsidy, Senator Packwood has cited three other groups which the Congress decided to help. In those cases (highways, airways and home construction) it provided assistance to individuals or public bodies through its taxing powers, including user taxes, excise taxes, general revenues or other devices such as tax deductions and not through statutorily-directed intra-industry subsidies.

When GTE's Chairman, Mr. Theodore Brophy, testified at the recent joint hearings, he entered into evidence a memorandum from Counsel, Sullivan and Cromwell, pertaining to the proposed "charge" to be collected from those by-passing the local exchange. That memorandum concluded that mandating such a fee would likely be deemed an unconstitutional delegation of the Congress' taxing power because, among other things, the amount of the fee would be improperly left to the discretion of the Universal Service Board.

Under some pending bills, the amount of the universal service "charge" or the long distance carriers' "surcharge" would be determined pursuant to proceedings of the various state commissions (insofar as approving the costs to be recovered by local companies' rates, such as rate of return); of a Federal-State joint board; and of the FCC. This would seem to raise an equally serious question of unconstitutional delegation of the Congress' taxing power as to those connecting to the network, directly or indirectly.

As discussed above, universal telephone service was made possible not by intra-industry fund transfers, but by the Rural Telephone Act, which is financed from general revenues. Accordingly, any additional telephone rate subsidy which may be needed would be funded more appropriately through the existing (3 percent) telephone excise tax, through an expansion of that tax or a new dedicated tax, or from general revenues, perhaps under an extended or expanded Rural Telephone Act.

Competition needed to prevent technological stagnation; requires the introduction of cost-based pricing.

Before competition was permitted in the intercity transmission and equipment markets, consumers had little or no choice of service or telephone equipment, and technological advances were not applied to new products or services. With competition, innovations were introduced not only by the new competitiors but by AT&T as well. These included more efficient transmission modes (such as microwave relay, fiber optics, satellites, cellular radio, etc.), more advanced equipment with diverse capabilities (such as high-speed data transmission), a much wider range of services tailored to a variety of needs (such as packet switching), and a choice of vendors, each with unique service and price structures.

We are now on the verge of a comparable technological explosion in the local distribution markets. In fact, the local exchange facilities still exhibit the same technical deficiencies—with respect, for example, to the ability to transmit high speed

digital data—as characterized the long distance system until competition was introduced in 1959. Innovations which have been developed in recent years will permit the offering of many more types of local service, more efficient, high quality service, and a choice of service vendors. Implementation of these innovative services and technologies will provide all telephone subscribers with better service and reduced costs, just as implementation of long distance competition has done.

There is substantial reason to believe that freeing the BOCs from AT&T's control, and even the so-called "threat" of by-pass will lead to innovations and economies in local service. First, there is evidence that Bell Labs did not give high priority to local exchange research needs. The BOC's will now have their own research arm in the Central Staff Organization. Second, the emergence of the potential for "economic by-pass" that is, the use of new technology to provide communications at costs below those of telephone exchange companies, should serve as a strong stimulus to the improvement of the local exchange systems.

Officials of some of the to-be-divested BOCs have spoken of the need to be allowed to by-pass themselves with such technology, which should bring improvements in the range of services offered, as well as in the efficient and economical delivery of conventional voice service. Such improvements will not be made, however, either by the telephone companies or by their competitors if Congress inhibits innovation by taxing or prohibiting the development of by-pass or competing systems in order to subsidize or "protect" the existing telephone companies. Nor will they occur if Congress revokes the FCC's authority over depreciation policy, as several of the bills would do. That would permit the states to reintroduce the short-sighted, stretched-out depreciation rates of past years which have helped to make local systems vulnerable to by-pass because they have failed to keep up with the state of the art.

Enactment of some of the pending legislative proposals could cause the needed diversity to be unavailable. The incentive for American companies to invest in innovative technology would be absent as well, opening the door to foreign competition and weakening the capacity of American companies to compete in world markets.

Telephone rate subsidies will cause significant adverse effects.

As the nation moves from a regulated telecommunications market place to one governed by competitive forces, pricing for services must be dictated by the relative costs of providing those services. To the extent that one service is subsidized, such as local calling, those using that service will not pay the true costs of providing it. Likewise, those using the services from which revenues are being drained to provide the subsidy will pay an amount in excess of what it costs to provide those services. This would cause severe market disruption and result in signficant, adverse economic and anticompetitive dislocations.

First, an inefficient provider of a subsidized service loses the incentive to become more efficient. After all, why should he invest in modern plant or equipment to enhance the efficiency of his system if the government will guarantee that a group of more efficient service providers will make payments to him so that his customers' rates will be kept low and, perhaps, while the state commission allows him a high rate of return?

Second, an efficient provider of a service from which the subsidy is being taken could lose the relative competitive benefit of his efficiency and discourage his expansion. A very efficient long distance carrier, for example, whose rates may be 50 percent less than his competitors', could have rates that are only 20 percent less if a per-minute or per-call surcharge to fund a subsidy is added in. Since he has no control over the subsidy amount, the advantages of his efficiency would be obscured and he may cease to offer the relative price advantage to his customers which he had earned by his efficient operation. (This problem could be ameliorated if surcharges were ad valorem, or set as a percentage of his charges for service rather than based on number of calls or minutes of use.)

Third, to the extent that rates are subsidized even in an efficiently operated exchange area, consumers will be artificially encouraged to use a system which is unable to recover its costs, causing the need for increased investment and even larger subsidies. Likewise, consumers of long distance services will be discouraged from using that service since the price is inflated due to the subsidy requirement. This, in turn, could depress long distance calling and reduce revenues for local exchange companies since long distance companies are their biggest customers. This result would be completely opposite to the objective of many of the pending subsidy proposals.

Finally, to the extent that the charges for services provided to long distance companies exceed the costs of providing those services, the long distance companies would be justified, indeed forced, to use or develop alternative means of filling their needs. Thus, excessive charges on long distance communications will exacerbate the

problem of economic by-pass (as to which the exchange companies would otherwise have a sound economic and technological response) and create an incentive for uneconomic by-pass, to which there is no response save continually growing and increasingly counter-productive subsidies.

Senator GORTON. Thank you very much, Mr. Jasper.

Mr. Tuttle.

Mr. TUTTLE. Thank you very much, Senator Gorton. I appreciate the opportunity to appear before you today to discuss the views of my company on S. 1660. My name is F. Thomas Tuttle. I am vice president, regulatory and industry relations counsel, of Satellite Business Systems. SBS is a telecommunications common carrier authorized by the FCC to provide voice, data, video, and other services via statellite within the United States and internationally.

We recognize the concerns that the Congress has for universal service and local phone charges. However, we do not believe that S. 1660 is the right answer to those concerns. Rather, in our view, S. 1660 as it is now drafted would seriouly inhibit a developing, dynamic, and increasingly competitive industry. It would not, we believe, inure to the benefit of local or long distance telecommunications companies or, more importantly, to their customers. It would provide disincentives for efficiency and innovation and could well cause increases in everyone's local and long distance telephone rates while lowering service quality.

Rather than preserving universal telephone service, S. 1660 would indiscriminately subsidize rich and poor alike without regard to need, while taxing both rich and poor to pay those subsidies. The same infirmities apply to most of the dozen similar bills introduced in both Houses.

First, let's look at the universal service question which the bills are designed to preserve. Is there a threat to such service? Earlier speakers have indicated that the record is unclear on that, but it is certainly possible that a small percentage of lower income individuals might cancel their telephone service if local rates rise significantly.

To address this possible problem, S. 1660 would broadly subsidize all intraLATA service in all telephone exchanges whose costs exceed 110 percent of the national average. No incentives are provided in that bill to keep the national average low, and no effort is made to target the subsidy to subscribers who would otherwise be unable to afford service. All those who make long distance telephone calls would subsidize service to all subscribers in high-cost areas, even though the local rates nationwide will likely rise, along with long distance rates.

Who really benefits in that situation? Certainly the benefit flows to people besides the person who can't afford to take the phone service and who would drop off of the network.

Second, besides imposing a broad subsidy, S. 1660 and other pending bills seek to solve the threat to universal service by placing the nontraffic sensitive subscriber loop costs back on the interexchange carriers. Will this cost shift prevent local telephone rate increases? As Mr. Jasper has indicated, only to a very minor extent. Most of the possible local rate increases are entirely unrelated to the FCC's access charge decision, nor are they caused by competition or by the AT&T divestiture. Instead, the bulk are

claimed to be needed because of accelerated depreciation and increases in the cost of capital. The FCC access decision creates no new costs. It merely shifts cost recovery from long distance to local subscribers.

S. 1660 in that respect does not deal with the pending rate increase requests but only focuses on the cost shift. It is not credible in our view that the first year's $2 per month charge imposed by the FCC's access charge order will cause large-scale cancellation of residential phone service. Even if you look beyond the first year and compare the increases that the FCC has included, it is not likely, we think, that major dislocations would come strictly from that transfer of NTS costs.

If universal service is actually undermined by the rate increases that we are looking at, the cause in our view is not the FCC's action but increases that are not affected by S. 1660.

Therefore, we suggest that if Congress believes that subsidies are required to preserve universal service, we should target a subsidized lifeline service to the truly needy. SBS would support such a carefully drawn targeted subsidy. In this regard, we have suggested that a portion of the revenue from the existing telephone excise tax, notwithstanding that that tax falls within the category of a luxury tax, could be earmarked for this subsidy or that a small tax be imposed on all telecommunications services, facilities, and equipment.

Finally, bypass. Is bypass a real threat? We think it is not just a threat, it is a fact. It is not a question of it being a threat. Bypass is out there today. Our company bypasses. Almost every larger user of service in some way, shape, or form considers bypass or is engaged in bypass right now. In our view, it would not be good policy, it would not be good for suppliers of service, it would not be good for users to simply prohibit or penalize bypass. We think the FCC's decision in that respect represents a rational access charge structure in the present environment. While we strongly disagree with some of the provisions of the order regarding the transition to equal access, we fully concur with the cornerstone principle, which is the removal of the subsidy inherent in the present procedures and thus prevent uneconomic bypass.

The decision would, over time, shift the dedicated subscriber line cost to the only entity that has caused those costs to be incurred, which is the subscriber. It has occasionally been suggested that long distance carriers like SBS benefit from the universal service that is provided through that subsidy. I wish someone would explain to me how SBS benefits or its customers benefit from having users on the network who do not ever use long distance phone service either to make long distance calls or to receive long distance calls.

In conclusion, we think that the FCC's decision is basically a sound one. It has provided for a subsidy in the form of a high-cost factor. It has provided for access charge waivers if they are shown to be necessary. It has provided for a gradual transition to soften any immediate impact, and it has provided for continuing review, so that the FCC has the opportunity to take corrective action if necessary.

We do not believe it is a radical or extreme approach, and it would not cause major and immediate disclocations of local residential users. Indeed, one might be concerned that the FCC's order causes the greatest risk of rate shock in the area of business users and AT&T's competitors who are facing substantial cost increases under that order.

Therefore, since the FCC's decision is directed at moving local distribution charges toward costs and relying on competition and new technology rather than artificial subsidies to achieve the best service at the lowest rates, we believe that it would not be good policy for the Congress to reverse that decision through passage of S. 1660.

Thank you.

[The statement follows:]

STATEMENT OF F. THOMAS TUTTLE, VICE PRESIDENT, REGULATORY AND INDUSTRY RELATIONS COUNSEL, SATELLITE BUSINESS SYSTEMS

I appreciate the opportunity to appear before you to discuss the views of my company on S. 1660, the Universal Telephone Service Preservation Act of 1983.

My name is F. Thomas Tuttle. I am Vice President, Regulatory and Industry Relations Counsel, of Satellite Business Systems. SBS is a telecommunications common carrier authorized by the Federal Communications Commission to provide voice, data, video, and other telecommunications services within the United States and internationally. We utilize three SBS-owned satellites and more than 100 earth station complexes as the backbone facilities of our network. In addition, SBS leases intercity facilities from other carriers and secures thousands of local distribution lines from telephone companies in the cities which we serve. Using these facilities, SBS offers sophisticated, digital private network and public long distance telephone services, leases satellite transponders, and has plans to expand into additional specialized telecommunications services.

SBS believes that S. 1660, as now drafted, would seriously inhibit a developing, dynamic, and increasingly competitive industry. It would not, we believe, inure to the benefit of local or long distance telecommunications companies or, more importantly, their customers. It provides disincentives for efficiency and innovation and could well cause significant increases in everyone's local and long distance telephone rates while lowering service quality. Rather than preserving "universal telephone service," S. 1660 would indiscriminately subsidize rich and poor alike without regard to need, while taxing both rich and poor to pay those subsidies. The same infirmities apply to most of the dozen similar bills introduced in both Houses.

In its rush to enact some "universal service" legislation, whether needed or not, Congress is failing to examine the complex economics and market inter-relationships of the various aspects of the telecommunications industry. The result could be legislation which has superficial appeal, but which could handicap an industry in which the United States is a world technological leader. And, as written, S. 1660 would not carry out its own stated goals of preserving universal local telephone service.

Before advancing legislation any further, the Congress should first look at the problem it seeks to solve, determine if the problem truly exists, then, if it does exist, find narrowly crafted solutions targeted to this real problem. Instead, it appears to us that S. 1660 and its brethren are solutions in search of a problem.

These bills are designed to preserve "universal telephone service." Is there a threat to such service? From the record before this Committee, as well as the information before the FCC, the answer is unclear. However, it is possible that a small but unknown percentage of individuals may cancel their telephone service if rates rise significantly. To prevent this possible problem S. 1660 would subsidize intra-LATA service in all telephone exchanges whose costs exceed 110 percent of the national average. No incentives are provided to keep the national average low. Nor is there any targeting to subsidize only those subscribers who would otherwise be unable to afford service. All those who make long distance calls would subsidize service to all subscribers in high-costs areas, even though local rates nationwide will likely rise, along with long distance rates. Who really benefits?

Besides this broad subsidy, S. 1660 and other pending bills seek to "solve" the perceived threat to universal service by placing the non-traffic sensitive subscriber loop

costs back on interexchange carriers. Will this prevent local telephone rates increases? Only to a minor extent. Most of the possible local rate increases are entirely unrelated to the FCC's access charge decision. Nor are they caused by competition or by the AT&T divestiture. Instead, the bulk of the pending rate increase requests are claimed to be needed because of accelerated depreciation and increases in the cost of capital. Finally, the FCC action creates no new costs; it merely shifts recovery of certain costs from long distance to local subscribers. This shift does not make overall telephone service either cheaper or more expensive, since the costs must be recovered somewhere.

The FCC has been blamed for causing rapid increases in depreciation expenses. Instead, the FCC, State Commissions, and the telephone companies have together provided for historically protracted depreciation lives, causing telephone companies to retain in their rate bases billions of dollars of undepreciated, often obsolete, plant. With the pressure of competition and rapid evolution of new technology, telephone companies found that they could not compete unless they were able to rid their rate bases of this plant and accelerate the depreciation of new plant. Failure to do so would ultimately cause the telephone companies to be stuck with obsolete plant and inflated rate bases as they seek to modernize their facilities.

While a more rational historic depreciation policy would have prevented the sudden expense increases now being experienced, the result of shortened depreciation lives will ultimately be lower rates and more efficient service to the public. Giving the States authority to reverse the FCC's recent depreciation changes, as proposed in the House Committee Bill, H.R. 3621, will benefit neither the public nor exchange or interexchange carriers.

A second justification for the large pending rate hike requests is increased cost of capital. Telcos are seeking to demonstrate that their costs of equity are rising. Coupled with maturity of low-interest embedded debt issues, the result is requests for significant increases in the authorized rate of return.

It must also be realized that these rate increase filings are only requests; they have not, for the most part, been granted. It is very likely that State Commissions will follow their usual practice and find large portions unjustified. Congress should not move forward with legislation on the basis of mere rate requests, large portions of which may be rejected.

Furthermore, S. 1660 does not deal with any of these pending requests. Instead, it focuses only on the FCC's action shifting the collection of nontraffic sensitive costs, resulting in a relatively small additional charge to be placed directly on the telephone subscriber. It is inconceivable that a $2.00 per month charge, gradually rising over six years, will cause large-scale cancellation of residential telephone service. If universal service is in any way undermined by actually granted rate increases, the cause is not the FCC's action, but increases not affected by S. 1660.

The FCC's decision represents the culmination of a multi-year inquiry into the most rational access charge structure in the present telecommunications environment, consistent with the overall public interest. While SBS strongly disagrees with some of the conclusions reached by the Commission, we definitely concur with the FCC's cornerstone principle—removal of the uneconomic and senseless subsidies inherent in the present procedures.

The FCC's decision would, over time, charge the full costs of the dedicated subscriber line to the only entity which caused the costs to be incurred—the subscriber. That line is the only means of obtaining basic telephone service. Whether the service is used entirely for local calls, entirely for long distance, or for both, the costs are incurred solely as a result of telephone service being provided to that customer.

At the hearings in Washington, D.C. there was such talk about who benefits from the subscriber line. It was suggested that interexchange carriers somehow "benefit," since their customers have access to that subscriber's telephone, and therefore the service they provide is more valuable. This, however, begs the question. A customer who has a telephone causes the cost of that telephone to be incurred. Whether or not he places or receives long distance calls, he, not the long distance carrier, benefits from his having that telephone service and having the ability to place and receive calls.

It was suggested that subscribers who neither place nor receive long distance calls should pay less than the cost of the subscriber loop. That is, that service should be subsidized by long distance carriers, who "benefit" from universal service. I wish someone could explain to me how SBS, or our customers, benefit from a local telephone subscriber who neither places nor receives long distance calls, and why we, and our users, should subsidize the cost of his local service.

It would certainly be reasonable, however, for Congress to target a subsidy of "lifeline" service to the truly needy. SBS would support such narrowly-drawn, tar-

geted subsidy. It is suggested that a portion of the existing telephone excise tax, presently paid by our customers, be ear-marked for that purpose, or that a special tax of 1 percent or less be imposed on all telecommunications services, facilities, and equipment.

I would like to turn now to another area about which much was said at the Washington, D.C. hearings—bypass. Bypass has becomé a derogatory term for competition in the local distribution market. A number of technologies have developed over recent years which supplement existing twisted pair telephone lines to deliver service to the customer. Some of these were developed because existing facilities were technically incapable of handling the bandwidth required for innovative services. Others evolved for purely economic reasons—they were more efficient, less costly ways of distributing telecommunications.

SBS's Communications Network Service (CNS), a broadband digital private line network service currently provided to 18 large customers, with six more customers under contract but not yet in service, offers communications among widely dispersed locations via customer-premises earth stations. Terrestrial lines, generally leased from the local telephone company, link additional locations to those earth stations, and most customers also connect off their networks using local telco facilities.

While a great many telephone company facilities are therefore used in CNS, much of the intracompany communications travels directly among earth stations via our satellite network. Not only is such direct communication the most efficient and economic way of serving widely-dispersed companies with very large communications needs, but the local telephone company plant is often incapable of distributing broadband digital communications of the type and quality demanded by our customers. While technically "bypass" under the provisions of some of the pending bills, we view CNS as an efficient, state-of-the-art use of advanced satellite telecommunications. Any restriction, tax, or other penalty on such a system would upset the delicate economics of the CNS offering and deprive users, such a Boeing Computer Systems here in Washington, of the advantages of our advanced telecommunications system.

Far from harming local exchange carriers, services such as CNS, which provide some direct communications but which also use exchange carrier facilities heavily, have a positive effect on telephone company revenues. They do not deprive exchange carriers of customers which they would otherwise have, while they provide additional business through use of telephone company facilities.

On the other hand, exchange carriers, and their local customers, are seriously harmed if uneconomic bypass is encouraged through artificially imposed subsidization. As the FCC found, the present separations and settlements system skews the local distribution market by affording incentives to construct otherwise uneconomic bypass systems. Once built, these systems will continue to be utilized even if the subsidies are removed, since the sunk costs must be recovered. Only by removing subsidies before uneconomic bypass systems are constructed can exchange carriers be protected.

An alternative, equally inappropriate, approach proposed by some at the Washington, D.C., hearing is to provide restrictions or disincentives to build any bypass system, economic as well as uneconomic, while retaining heavy subsidies. Section 6 of S. 1660, while unclear, would appear to impose a fine for some forms of bypass. While this approach would at first seem to cure the "symptoms" caused by the subsidy "disease," it would also be counter-productive to the ratepayer. By penalizing systems which compete with exchange carriers on an economic, head-to-head basis, such provisions inhibit the development of innovative local distribution technologies. Further, incumbent exchange carriers, with no competition, are less likely to modernize their local networks, invest in new technology, and actively market new and innovative services. With mainly less efficient plant in operation, the customer is deprived of both the service improvements inherent in advanced technology and the economies of more highly efficient plant. Finally, the result will be higher, not lower, rates for both local and long distance service.

My testimony so far has focused on long-term policy issues, as the telecommunications industry moves from historical monopoly to an increasingly competitive structure. I would like to touch briefly on a shorter-range competitive concern, but one which could have a significant effect on the continued development of a competitive long distance telephone market during the next few years. One of the justifications for the AT&T divestiture decree was the difference in the quality of local access provided by the Bell Operating Companies (BOC's) to AT&T and to its competitors, such as SBS. The decree requires these inequities to be removed over time. However, for a number of years, perhaps extending into the 1990s, a sizeable percentage of

telephone subscribers will continue to be served by central offices which provide superior access to AT&T.

Among the most critical differences in the access quality SBS obtains vis-a-vis that provided AT&T are the following:

An AT&T customer need only dial 10 to 11 digits to complete a long distance call, while customers of SBS Skyline long distance service must dial 23 digits, since we are not provided Automatic Number Identification.

AT&T's service can use dial or tone telephones, while an SBS customer can use only tone telephones. This is because the BOCs will not pass through dial pulses or convert them to tones for us.

SBS must install expensive additional equipment to provide good quality voice service to compensate for the inferior technical quality of the local lines we are provided compared to the high-quality AT&T access lines.

SBS cannot offer a service comparable to AT&T's 800 (IN-WATS) service, as a result of the inferior access configurations provided us.

The divestiture decree requires all BOC offices to provide equal access by September, 1986. However, information obtained from the BOCs indicate that exceptions and waivers provided for in the decree will result in as many as 25 percent of telephone subscribers being served by offices not equipped for equal access well after 1986. As partial compensation for these inequalities in access, competitors presently are charged less for exchange access than is AT&T. The recent FCC access decision, however, would substantially narrow that differential, beginning in 1984, even though no significant improvement in access quality is promised until late 1985 and 1986.

The House Committee Bill, H.R. 3621, provides some relief by freezing the current access charge rates until mid-1985, in recognition of continued inferior access. If legislation is enacted this Congress, SBS believes that the House approach should be adopted and expanded to recognize the vast differences in the quality of access. Preservation of the present arrangements pending a finding by the Commission that equal access has in fact been provided would be the most reasonable approach.

In summary, SBS believes that reversal of the cornerstone aspects of the FCC's access charge plan would be unwise public policy and detrimental to the public in general. If any subsidies are needed to preserve universal service, they should be narrowly targeted and financed not by a narrow tax on long distance service, but through a broader-based telecommunications tax. Congress should not, however, rush to enact sweeping legislation in response to a possible narrow problem.

The telecommunications industry is in state of rapid evolution. The AT&T divestiture brings with it for the first time the real possibility that effective competition will develop in the marketplace. The technological potential of satellites, fiber optics, and other new transmission media are just beginning to be felt. It would be a major travesty for the American people if hastily-enacted and ill-considered legislation were to curtail the expansion of this dynamic industry and prevent fulfillment of its exciting potential.

Thank you for inviting SBS to testify, and I'll be glad to respond to any questions.

Senator GORTON. Thank you, Mr. Tuttle.

Mr. Horley?

Mr. HORLEY. Thank you, Senator Gorton.

My name is Al Horley, and I am chairman of a small electronic startup company in California called Vitalink. We are in the business of essentially bypassing the present communications system by providing high speed data circuits, a very small replica of some portion of what SBS does. Our company has about 50 employees, and at present, we have less than $5 million in revenue. So you can see that we are not a big factor in the communications industry as a whole.

I will not read my prepared testimony but rather confine myself to a few ad hoc oral comments.

However, I felt it important to come and speak before your committee because I am quite concerned about some of the policy aspects of what I see embodied in S. 1660 and the equivalent bills that are in the House on communications. I feel it is a very serious matter to reverse the trend that has been set in place in the last 10

years of opening up the communication industry to competition. I furthermore seriously question the proposition that subsidizing the local Bell operating companies or equivalent telcos, is equivalent to subsidizing consumers. These proposals miss the distinction between the operating company, which to me is just a competitor, and the consumer, with whom I can sympathize especially when I get my telephone bill.

I certainly question that any proposal that uses a discriminatory tax upon the most innovative sector of the communications industry to subsidize that portion of the communications industry which at the very least has had a rather conservative history dominated by mastering how to deal with regulatory and government agencies as opposed to learning how to deal with competition and costs.

I suppose that furthermore I would simply make the personal observation that it seems to me that the factor that has been most focused on, the local loop or the wire, has been in the ground for some 50 years, and my little economics training would tell me that it ought to be treated as a sunk cost at this point in time. I wonder how that element of cost can now somehow be expanded to cover all of the communications costs associated with providing telephone service.

It is my opinion that the local telcos at the present time are taking advantage of the divestiture and of the changes in the FCC's policymaking to get the ratepayer to finance the development of a whole new communications system which is not directed at providing service for the local ratepayer at all, but is directed at providing a competitive data service and other related products aimed at the business community. I guess that is my most serious objection to the portions of the pending legislation that would tax bypassers and use those funds to support the local telephone operating companies. I suppose that is my most serious objection and point. I feel that what is important is to have a competitive industry that will create the pressures to lower the costs. I am quite sympathetic with the notion that there should be some kind of lifeline service or universal telephone service, and that in fact it might be appropriate to support that from public funds or otherwise for low-income people.

But I fail to see how the concept of universal telephone service requires a subsidy that allows the local telephone operating company to provide a one and a half megabit data service to its customer in competition with a product that we offer. I fail to see how that is at all related to providing telephone service to a person in rural America.

Thank you, sir.

[The statement follows:]

STATEMENT OF DR. ALBERT L. HORLEY, CHAIRMAN, VITALINK COMMUNICATIONS CORP.

Thank you for providing this opportunity to express my views on S1660 and its potential effect on the U.S. communications industry.

My name is Albert Horley. I am Chairman of the Board of Vitalink Communications Corporation, a three year old venture capital funded start up; supplying advanced satellite data networks. Vitalink equipment is installed on our customers' premises and provides a direct high speed satellite connection between data processing equipment at multiple locations. The architecture of our network takes full ad-

vantage of the broadband broadcast nature of satellite transmissions and consequently provides many performance and cost advantages over terrestrial networks.

I am here because I am concerned that S1660 and its companion House Bill HR 3621 signal a reversal of Government policy concerning competition in the communications industry. I believe that the record of the last ten years, during which time the Congress, the Justice Department, and the FCC all acted to steadily increase the scope of competition in the communications industry, amply demonstrates that competition can and does provide direct consumer benefit as well as important employment opportunities in a healthy growing industry.

I do not quarrel with S1660's broad objective of insuring the universal availability of basic telephone service at a reasonable rate. Nor do I object to the notion that those whose services directly rely upon, and benefit from, the existence of the local telephone plant should bear a fair share of the cost of maintaining it. I believe that the system of access charges proposed by the FCC recognizes and addresses this need. I am however, deeply troubled by the bypass language in both S1660 and HR 3621 that has the effect of taxing all who would provide electronic communications services irrespective of their use of, or dependence on, the local telephone plant, and using the funds so generated to subsidize large well-established business organizations, the local telephone operating companies, who can and will compete with them.

The local operating companies have readily admitted that the first priority use of the access payments will be the construction of new plant to provide advanced services to the business community and not to reduce local subscriber rates. Why? They are responding to competition in the business data communications area. I submit that it is only competition that will lead to reduced costs and the introduction of innovative new services. Vitalink has only a little more than 50 employees and less than $5 million a year in revenue, yet when AT&T filed with the FCC to reduce the tariffed rate for its long distance high speed digital terrestrial service it cited competition from Vitalink as one of the reasons for needing to reduce its rates!

In order for a service like Vitalink's to compete in as conservative an environment as business communications, we must offer both price advantages greater than 20% and operational and performance advantages. The double handicap of a tax that is used to subsidize our competitor may be more of a burden than even an extraordinarily innovative and aggressive business can survive.

As one who persuaded a substantial number of investors to place a large amount of high risk capital in a new communications venture, I can tell you that the passage of either S1660 or HR 3621 in their present forms will put a real chill on new investments in this area and will ultimately mean that the consumer and or the Government will have to supply those missing investment dollars.

There is something strangely ironic about a Congressional action that subsidizes the large and conservative by taxing the small and innovative for the purpose of preserving a consumer service that the very same Congress still sees fit to tax a luxury.

In summary I believe: 1. That the greatest long run benefit to the consumer will come through increased competition, 2. That the FCC proposed system of access charges adequately responds to the need to have business and long distance users pay their fair share for the benefit they derive from the existence of the local telephone plant. (i.e., I do not see the need for new legislation.) 3. That new products and services that completely bypass the local telephone plant, do not connect to it and go far beyond "Plain Old Telephone Service" in their technical capability should not be taxed to help an already strong, but conservative competitor (i.e., I specifically oppose the broad definition of bypass in S1660 Sec 4b and HR 3621 Sec 4b–4A, 4B, 6A).

In closing I would again like to thank you for this opportunity to express my views on the pending legislation. As a consumer, I believe I understand and appreciate the Congress' motivation, but as a businessman and a participant in this industry I believe that the approach proposed will not lead to the desired results.

Senator GORTON. Thank you. And Mr. Ayres.

Mr. AYRES. Good morning, Senator Gorton. My name is M. U. Ayres. I am the general manager of Network Services for the Boeing Computer Services Co., the agent for the telecommunications services for the Boeing Co. It is a pleasure to be here today to present my views on universal telephone service and telephone rate legislation.

Boeing Computer Services provides timesharing and other remote data processing services. Our users are located all over the world, and they use a wide variety of telecommunications services to fulfill their data processing needs. Boeing Computer Services' business, as well as all of Boeing's business, depends on the availability of high quality, reasonably priced telecommunications services, and we are directly affected by any change which would alter our ability to obtain or provide these services. BCS operates one of the largest private telecommunication networks in the world. The network is a complex combination of privately owned equipment and common carrier services.

Boeing Computer Services was formed in May 1970 by consolidating 13 separate organizations. The company began with about $100 million in computing and communications equipment and 2,000 people supporting Boeing operations. Today Boeing Computer Service employs over 7,000 people with over $500 million of computer and communications equipment. Boeing still uses the majority of our services but the commercial business is growing at a faster rate than the computer services industry as a whole. In addition, we provide telephone data and message services for the Boeing Co. throughout the United States and most of the free world.

We strongly support the goal of universal telephone service. Every telephone user benefits from the ability to call anyone else, anywhere, at any other location. The ability to reach out and touch someone on the other side of the country is often as important as the ability to call across town or across the street. There is no reason to believe that universal telephone service is threatened. The FCC has taken notice of the high cost of providing service in rural areas and has established a limited universal service fund to maintain reasonable rates in those areas. The FCC has also provided for a large percentage of the nontraffic sensitive costs to be borne by the business user directly or indirectly through its proposed access charge formula.

Further, the FCC is establishing a plan for monitoring local rates and determining what further action is necessary to preserve universal service.

Judge Greene has also protected universal service. He has permitted the Bell operating companies into the printed Yellow Pages market and into the customer premise equipment market. He has granted the BOC's all Bell System patents, the sole use of the Bell name and logo, and has required AT&T to guarantee the cost of reconfiguring the network to provide equal access to all long-distance carriers.

State public utility commissions continue to have the power and the duty to investigate all rate requests and deny those requests that are not justified. The FCC and State regulators have all the expertise and procedures necessary to ensure that universal service is protected.

The FCC access charge order is a significant step toward establishing an equitable price-cost relationship. It costs an average of $26 per month to provide a single telephone line to a residential or business customer. The cost is the same whether the customer uses the telephone or not, or ever makes or receives a long-distance call. Residential rates are kept artificially low by a system of subsidies

from long-distance users to the local telephone company. Residential customers now pay roughly one-third of what they paid for telephone service in 1950 measured in real dollars. This has been possible in part because of technological improvements and long-distance rate subsidies. Because of this premium price for long-distance service, large business users have been encouraged to use dedicated private networks to achieve lower costs for long-distance communications. The FCC's access charge order which reduces these service subsidies is a significant step toward correcting this problem and reduces the incentive to duplicate the exchange network.

It appears from estimates that access charges will account for less than 15 percent of the costs for local residential telephone service.

Although I will address my comments to S. 1660, the Universal Telephone Service Preservation Act of 1983, the other bills currently before Congress deserve similar consideration. The objective of S. 1660 to establish incentives for efficient investment decisions and technological choices will not be achieved by collection of a universal service charge that is applicable only to providers of interLATA services or private systems. Simply stated, the effect of S. 1660 is to create a financial incentive to bypass the local telephone network and then to impose fines for doing so.

Bypassing the local telephone exchange is a desirable solution to information needs not provided by traditional networks. It may occur because the local telephone company does not provide the type of service needed or the service is not of sufficient quality or the price for the service is too high compared to the value received.

The most significant benefit of bypass alternatives is the incentive which it creates for local telephone companies to satisfy users' needs, to implement new technologies, and to control their costs as we enter the new information services age.

Bypass alternatives promote technological innovation as people search for new ways to provide communications at lower cost. In addition to introducing new services to a broader spectrum of users, these new technologies will also enable the local exchange companies to control and reduce the cost of providing local exchange service. Lower operating costs mean that basic telephone service will remain within the reach of more subscribers without the need for subsidies and without the misallocation of resources.

The existence of a bypass demand will also have a beneficial effect on the U.S. technological leadership. If bypass alternatives are discouraged, new distribution technologies will still be developed, but not by U.S. companies. Bypass capabilities serve another valuable purpose. They satisfy highly specialized users' needs that local telephone companies may not choose to meet.

In view of the positive benefits of bypass, it is not necessary for Congress to discourage bypass in order to preserve universal service. There are other alternatives available which can be used to keep the rates for basic telephone service at reasonable and affordable levels.

If at some point in the future it appears that universal service is threatened, we should consider legislation meeting several criteria. First, any legislation should provide for subsidies to the needy. It is

the poor that require and deserve our assistance. Second, the cost of any telephone subsidies that become necessary should be paid in the same manner as other social programs. Finally, the legislation should contain nothing to discourage or prohibit the development and implementation of new telecommunications technologies as we enter the information services age.

In conclusion, I would urge you to avoid enacting a legislative solution to a problem that may not exist. We can best protect universal service by relying on competitive forces to allocate resources and spur technical innovation.

Thank you for this opportunity.

[The statement follows:]

STATEMENT OF M. U. AYRES

Good morning. My name is M. U. Ayres, and I am General Manager of Network Services for Boeing Computer Services. It is a pleasure to be here today to present the views of my company on universal telephone service and telephone rates legislation.

BOEING COMPUTER SERVICES

Boeing Computer Services, or BCS, is in the business of providing timesharing and other remote access data processing services. Our customers are spread out all over the world, but they use our computers located thousands of miles away to fulfill their own data processing needs. Our business is completely dependent upon the availability of high quality, reasonably priced communications services, and we are obviously vitally interested in, and directly affected by, any change in the regulatory environment which would alter our ability to obtain these services.

BCS operates one of the largest privately owned telecommunications networks in the world. The network is comprised of landlines, microwave systems, and satellites that link BCS's five data processing centers with each other and with its government and commercial customers.

The Boeing Company started BCS in May, 1970, by consolidating 13 separate computing organizations within one central organization. The company began with about $100 million in computing equipment and an established staff of 2,000 that had been supporting Boeing operations. Today, BCS employs nearly 7,000 people and owns $500 million in computer equipment. Boeing still accounts for 60 percent of BCS's business, but the outside commercial business is growing at a faster rate than the computer services industry as a whole.

We at BCS join a tremendous number and range of telephone users in the belief that universal service legislation is unnecessary and ill advised at this time. Although the telephone system is in transition, universal service is not threatened. Most of the legislation proposed thus far to deal with this perceived problem will create gross inefficiencies in the telephone marketplace and in the economy as a whole, and will slow the rate of technological advance in this country.

If, at some future date, legislation should become necessary, we would look for legislation that would cause the least possible distortion in the marketplace. We would call for clearly identified subsidies targeted to the people who truly need the help, and paid for by the broadest range of people possible.

UNIVERSAL SERVICE IS NOT THREATENED BY IMPENDING CHANGES IN THE TELEPHONE SYSTEM

BCS strongly supports the goal of universal telephone service. Our society has reached the point where the telephone seems almost as necessary to life as food and water. Every telephone user benefits from the ability to call anyone else in the country. I will touch briefly on this point later, but I would stress the words "anyone else in the country." The ability to "reach out and touch someone" on the other side of the continent is often as important as the ability to call across town or across the street.

There is no reason to believe that universal service is threatened. The FCC access charge order receiving so much Congressional attention these days will have relatively little effect on residential rates. Charges under the order will be phased in over a period of five years, and the initial charge will be $2 a month. Throughout

the transition period and beyond, residential charges will be kept low by transferring extra charges to business users. In 1984, access charges for business will be three times the charge for residential customers, and in later years business charges will be as much as twice the amount paid by residential customers. In addition, the FCC will permit state regulators to request waivers of the access charge for "lifeline" service to the truly needy. Several states have already acted to ensure that a minimum level of telephone service will be available to the poor for a mere $2 to $3 a month.

The FCC has also taken notice of the high costs in rural areas. The access charge order establishes a universal service fund to maintain reasonable rates in those areas. Further, the FCC is establishing a plan for monitoring local rates and determining what further action is necessary to preserve universal service.

Judge Greene has acted as well to protect universal service. He has permitted the Bell Operating Companies into the printed directory market and customer premises equipment market. He has granted the BOCs all Bell System patents with certain sublicensing rights, and sole use of the Bell name and logo, and has required AT&T to guarantee the cost of reconfiguring the network to provide equal access to all long distance carriers. Each of these actions will allow the BOCs to keep rates lower.

The power of state regulators ought not be forgotten in the rush to enact federal legislation. The mere fact that a local telephone company has requested an outrageously high rate increase does not mean that the rate increase is justified by its costs. There is reason to believe that some of the local telephone companies may be taking advantage of the confusion created by the breakup of AT&T and by the various FCC proceedings. State public utility commissions have the power and the duty to investigate all rate requests and deny those requests that are not justified by cost increases.

It appears, then, that enough people are watching the situation to prevent universal service from slipping away unnoticed. Thanks to Judge Greene, the Bell Operating Companies will begin their new lives on a firm financial footing. The FCC and state regulators have all the expertise and procedures necessary to ensure that universal service is protected.

THE FCC ACCESS CHARGE PLAN IS A TREMENDOUS IMPROVEMENT OVER THE EXISTING SYSTEM

Most Americans are proud of the fact that the United States operates on a free enterprise system. This system relies heavily on market forces to allocate resources among competing products and activities. This allocation mechanism works efficiently as long as prices bear a reasonable relationship to cost or there exists competition to force prices in the direction of costs. For several years now, the government has been reducing the regulation of our economic lives, and consumers have received the benefits in the form of a wide diversity of airfares and shipping services, and better financial products.

It has taken a very long time for competition to come to the telephone industry. Only recently have consumers begun to enjoy the lower prices offered by independent long distance carriers such as MCI and Sprint. The sheer number of carriers in the United States is an indication of how interested the American public is in lower long distance rates.

It is important to remember that what we are taling about here is something of a shellgame. It costs a certain minimum amount of money—hundreds of billions of dollars—to buy the quality and volume of telephone services to which we have become accustomed. It costs an average of $26 per month to provide a single telephone line to a residential or business customer. This cost is the same if the customer talks on the phone for one minute a month, or if he hangs up for one minute a month. It costs the same whether the customer ever makes or receives a long distance call, or whether his phone is even hooked up to the long distance network.

Yet it is a rare residential customer who pays full cost of his or her telephone line. Local rates are kept artificially low by a system of subsidies flowing from long distance users to the local telephone company. The amount of the subsidy is established by agreement between AT&T longlines and the local operating company.

The effect on local rates has been dramatic, Residential customers now pay roughly one-third of what they paid for telephone service in 1950, measured in real dollars. The average American spends a minute percentage of his day working to pay the cost of his local telephone service.

The effect on long distance telephone rates has been equally dramatic. Long distance rates are by one estimate 40 percent above what they would be without the

additional burden of subsidizing the local networks. As a result, individuals and businesses are discouraged from making long distance calls when it would otherwise be efficient to do so. Because long distance service has been seriously over-priced, hundreds of thousands of users have been encouraged to operate their own networks where they could better control the inflated costs of long distance.

The FCC's access charge order is a significant step toward correcting this problem. Local rates will eventually cover the costs of providing local service. Long distance service will eventually cost quite a bit less than it would otherwise. The effect of this change on our economic efficiency, and the benefits of those efficiencies to consumers, should not be underestimated, For example, the fact that it costs less to use BCS or another remote processing service means that goods and services provided by our customers costs less, and our incentives to innovate are greatly increased. Consumers may not be able to trace the dollars, but they certainly benefit.

It bears noting at this juncture that the access charge order is not to blame for the vast percentage of rate increases requested by local operating companies to date. Since September 1981, Bell Operating Companies have requested rate increases totalling $7.4 billion. Of that amount, $.2 billion or 29.5 percent would go to additional depreciation expenses allowed by the FCC. In addition, local telephone companies have requested funds to modernize their plant, install new technologies, and increase returns on invested capital. These increases would presumably have been requested regardless of whether or not the FCC had issued its access charge order.

The numbers available are only estimates, but they indicate that access charges do not deserve the attention they are receiving. It appears that these charges will cause less than 25 percent of the pending local rate increases requested, and in the end will account for less than 15 percent of the cost for local residential telphone service.

PENDING LEGISLATION CAN ONLY HAVE UNFORTUNATE RESULTS

The time has come for me to talk a little about the legislation curently under consideration by Congress. Although I will address my comments primarily to S. 1660, the Universal Telephone Service Preservation Act of 1983, the other bills currently before Congress can be criticized on many of the same grounds.

Simply stated, the primary effect of S. 1660 is to create enormous incentives to bypass the local telephone network, and then to impose enormous fees for doing so. The incentives are created by a subsidy system more damaging to the economy than the system currently in effect. S. 1660 would repeal the cost-base pricing features of the FCC's access charge order and replace it with a new entitlements program. The program will be funded by an apparently unlimited tax on long distance carriers, a tax that will ultimately be borne by everyone using long distance service. The program will give local telephone companies a blank check to pay for whatever costs they incur above 110 percent of the national average, regardless of how inefficient and unnecessary they are.

The result will be to drive long distance cost up with little corresponding reduction in local rates. When somebody else is picking up 90 percent of the tab, there seems little reason to care about cost increases. This is a tremendous step backward even from the current system, where the subsidy does not remove the incentives of local companies and state regualtors to keep costs down.

The higher long distance charges will create powerful incentives to build private networks that bypass the local telephone exchange. Yet S. 1660 discourages bypass—and the attending benefits—by requiring bypassers to pay the universal service charge or face fines that may reach $100,000 per phone call.

Bypass is a socially valuable marketplace response to commuinications needs not being satisfied by traditional networks. It may occur because the local telephone company does not provide the type of service users want, or the service is not of sufficient quality, or the price for the service is too high compared to the value received.

Although bypass is sometimes perceived as a threat to universal service and the viability of local telephone companies, bypass—or, more accurately, the possibility of bypass—actually benefits users and the carriers upon which they rely for service. Perhaps the most significant benefit of bypass is the incentive which it creates for local telephone companies to satisfy user needs, to implement new technologies, and to control their costs. The prospect of competition from alternative distribution technologies provides local telephone companies with a marketplace incentive not only to take advantage of new technologies, but also to exploit the untapped potential of their existing facilities in ways that satisfy user needs.

Bypass also promotes technological innovation, as potential bypassers search for new ways to provide local distribution services on a cost-effective basis. Today's new bypass technologies, developed and tested at no expense to the ratepayer, are likely to become the technology of tomorrow's telephone network. In addition to introducing new services to a broader spectrum of users, these new technologies will also enable carriers to control the costs of providing local exchange service. Lower costs mean that basic telephone service will remain within the reach of more subscribers, without the need for artificial subsidies and without the misallocation of resources which results from non-cost based pricing.

The existence of a bypass market will also have a beneficial effect on the United States' technological leadership. If bypass is permitted, United States companies will have an incentive to focus their research efforts on the development of alternative distribution technologies. If bypass is discouraged, new distribution technologies will still be developed, but not by United States companies. As a consequence, the United States telecommunications industry could well become dependent upon foreign technology.

In addition to innovation, bypass also serves another valuable purpose; it satisfies highly specialized user needs that local telephone companies are not now and, for sound management and policy reasons, may never be equipped to meet. For such users, bypass technology may represent the only acceptable alternative to regular exchange service. To deprive these users of efficient and essential communications service in the name of promoting universal service is plainly inconsistent, to say the least.

In view of the many positive benefits of bypass, there are no sound reasons why Congress should discourage bypass in order to preserve universal service. There are numerous other alternatives available, ranging from access charges to outright subsidies, which can be used to keep the rates for basic telephone service at reasonable and affordable levels. None of these alternatives requires Congress to prohibit bypass or to deprive the American public of the many benefits which bypass provides.

Although I understand the reasoning behind S. 1660, I cannot agree with it. The theory is that long distance carriers should pay for part of the local network, because they use the local network as a vehicle for delivering their services. But as I noted before, the fixed cost of the local network is not affected by the existence of long distance carriers. What, then, is their fair share?

We all think of universal service as connecting everyone in the country with everyone else. But by driving up the costs of long distance, we begin to limit the usefulness of the telephone. It is obvious that consumers will pay directly or indirectly for all increased long distance costs. There has been a great deal of speculation about who makes more long distance calls. Some say it's the rich, because they can afford it. Others say it's the poor, because it's less expensive than travelling. Bill McGowen of MCI has stated that 50 percent of all long distance calls are made by residential users. The bottom line is that we have a huge country that is largely held together by our communications networks, and we should be doing everything we can to encourage their networks to grow and prosper.

IF LEGISLATION BECOMES NECESSARY

I would like to think that I have convinced you that legislation is unnecessary this year. The court, the FCC, and State regulators have the matter under control.

If, at some point in the future, it appears that universal service is threatened, we would consider legislation that meets several criteria. First, any legislation should provide for subsidies targeted to the truly needy. Those who can afford to pay the full cost of their telephone service should be asked to do so, just as they pay the full cost of their food, health insurance, and utilities. Nobody is ever particularly happy about rate increases for telephone service or anything else, but the vast majority of Americans will pay the price if they can possibly afford it. It is the poor that require and deserve our assistance.

Second, the cost of telephone subsidies should be paid in the same manner as the cost of any other social program. Universal service is much more a social goal than anything else. Although the tendency is to follow tradition, it makes as much sense to pay for the subsidies with a tax on tobacco or lettuce as with taxes on other phone users. Ideally, however, the goal could be reached through a system of phone stamps or other transfer payments from the general treasury. The traditional method of subsidizing local rates through extra long distance charges should be avoided, because it makes no regulatory or economic sense.

Finally, the legislation should contain nothing to discourage or prohibit bypass of the local network. As I have already discussed at length, bypass is a tremendous benefit to society.

CONCLUSION

Once again, I would strongly urge you to avoid enacting a legislative solution to a problem that may not exist. Everything is under control as we move toward a competitive telephone system that still provides for universal service. We have given the United States the best telephone system in the world. We can best protect that system by relying to the greatest extent possible on competitive forces to allocate resources and spur technological innovation.

Thank you again for this opportunity to appear here today. I stand ready to answer any questions you may have.

Senator GORTON. Thank you very much, Mr. Ayres.

Each of you in the course of your testimony has opposed long-distance subsidies for local service, and yet you do support this FCC decision which includes a 1-cent-per-minute surcharge for universal service.

Is that not inconsistent?

At least Mr. Horley, in your oral testimony you had the virtue of consistency. I gathered you felt that any kind of universal service ought to be subsidized out of taxpayer funds rather than out of any kind of subsidy from communications service at all. Is that correct?

You oppose even the FCC decision as to how far it goes?

Mr. HORLEY. Yes, sir. I really believe that if in fact what we desire is a certain base level of telephone service available to all of the citizens, and it appears such that it is not possible for all people to afford it, that we really ought to look to the recourse of the general taxpayers' funds to support that. Anything else would tend to distort the investment.

Senator GORTON. That is destined to add to our deficit, I may say.

Mr. HORLEY. Well, I find it rather strange that the same Congress who was expressing a great deal of concern about the availability of universal telephone service at the same time maintains what amounts to a luxury tax on telephones. Part of that bill you get every month says excise tax, the same thing I pay for alcohol or tobacco or gasoline, all of which I presume the Government is trying to discourage the use of.

Senator GORTON. In any event, it is your view that the FCC did not go far enough.

Do any of the rest of you agree with that?

Mr. Tuttle?

Mr. TUTTLE. Yes; I would certainly say that we would agree that the FCC did not go far enough in the subsidy area. It would go farther, and as a general matter, those kinds of subsidies ought to be dealt with as they are in other social programs, through a funding mechanism. However, if you are talking about a subsidy that is sufficiently targeted in terms of the needy that it is serving and is sufficiently limited in its scope, it may be acceptable to have that subsidy imposed in the access charge arrangements. The difficulty with the S. 1660 approach is that it is not sufficiently targeted and it is too broad.

Senator GORTON. Mr. Jasper?

Mr. JASPER. Generally speaking, I guess our answer depends upon what the FCC decision is compared with. If the FCC decision

stands alone, it could surely be improved, but if it is compared to the bills that we are talking about, it looks terrific. The problem with the bills is that the subsidy thresholds are lower and the percentage contributions are higher. Those are all moves in the wrong direction.

Senator GORTON. Let's go on to the next logical question then.

If all long distance carriers and bypassers were charged a similar access charge or bypass charge, how could that be conceived as a disincentive to innovation? Isn't innovation now, at least prior to the FCC access change decision, simply subsidized by the fact that AT&T had artificially high long-distance costs?

Mr. JASPER. I will take a stab at it.

In the first place, any additional cost on a service may, at the margin, reduce the incentive to invest money in research or in innovation because the marginal cost of the service will be increased, and the likelihood that people will purchase that service is reduced so that in a theoretical economic model, any increased cost is a discouragement.

In terms of competing under AT&T's umbrella, if I can rephrase your question, it is our thesis that we have competed successfully because we have been innovative and economical, much more cost-effective than AT&T, and that has given us a price advantage, not any artificial price umbrella.

Mr. TUTTLE. If I may continue with that same line, I think what we are talking about is not simply innovation as between long-distance competitors, but also innovation at the local exchange level, and if you have an artificial raising of that local exchange entry barrier through too high access charges, what that means is that the local exchange company does not have to innovate quite as hard in order to provide the same level of service at the same low cost, in order to keep bypass out. So you are going to have a higher threshold of entry barrier in terms of competing bypass technology.

Senator GORTON. Even though you had what ought to be described as an even playing field.

Mr. TUTTLE. Even if it was evenhanded across all interexchange carriers, you would still have that same problem.

Mr. JASPER. Could I add one point?

Senator GORTON. Certainly.

Mr. JASPER. What we have in the local exchange situation is directly analogous to what we had in the long-distance network 25 years ago. That led to the FCC's initial decision to open long distance to a limited form of competition through private microwave systems. The reason was that the telephone network had not yet adopted in the late 1950's the technology of World War II with microwave relay and high-speed data transmission. The local exchange networks are still in the same situation 25 years later.

Senator GORTON. Mr. Jasper, you mentioned in both your written testimony and your oral testimony that any kind of bypass charges will cause litigation.

I suppose that is correct. Any action that we take or don't take, I suspect, will cause litigation. But are you questioning the right of Congress to regulate interstate communication by any form of charge or excise tax?

Mr. JASPER. I am questioning the approach used in the pending bills on constitutional grounds. The case is not that the Congress cannot tax the communications industry. Clearly it can. The question is can it delegate its taxing power to the FCC, to a universal service board, and to 50 State commissions as would be done by these bills? The Sullivan and Cromwell memorandum that Mr. Brophy entered into evidence concludes that the Congress cannot do so as to the tax on bypass, and I would extend their argument as to the surcharge on long-distance carriers.

Senator GORTON. Thank you.

Mr. Jasper, both you and Senator Williams, who led off this morning, testified that local telephone companies use monopoly revenue to subsidize competitive services. Interestingly enough, you take off from that position to arrive at opposite conclusions on the need for legislation.

Do you not have some concern of a need for protection from that kind of subsidized competition, if, in fact, it exists?

Mr. JASPER. The divestiture should have and would have prevented those possibilities, had it not been tinkered with in some ways by Judge Greene. That is, the theory of the divestiture was to separate monopoly from competitive enterprises, and it was on that theory that Mr. Baxter persuaded AT&T to agree to the separation of terminal equipment and long distance from the monpoly local service.

The judge muddied the waters a little bit in putting the local companies back into some aspects of competitive business, including marketing of terminal equipment and yellow pages advertising.

So the issue which would have been disposed of under the initial formulation of the divestiture agreement does remain, under its final formulation. And, since our companies are in the long distance transmission business, there is also the problem of possible cross subsidy of intra-LATA toll calls.

Senator Gorton: But you could live with it.

Mr. JASPER. Well, we are hopeful that if the Congress does anything, it might rationalize that situation so that we would have a national system of regulation that might be more supportive of competition.

But yes; we could live with it.

Senator GORTON. Finally, Mr. Ayres, your testimony includes the point that long distance carriers should not pay the costs, or any portion of the costs, of the local network because it is impossible to determine their fair share. Your conclusion seems to be that since that fair share cannot be determined, it is therefore zero.

How does that logically follow?

Mr. AYRES. Well, the determination of the plant to be allocated to the long distance network is not possible from any knowledge that I would have. The attempt to move the cost closer to the cause of the cost, I think, would result in the community of interest carrying the cost of access.

Senator GORTON. So you come to the conclusion that there should be none at all.

Mr. AYRES. Correct.

Senator GORTON. Well, again, I would like to thank each of you for testifying before us here today. You have been very helpful to us.

Our final panel will consist of Mr. Hill, Mr. Smith, and Mr. Ells. We will begin with Mr. Hill.

STATEMENTS OF RAY HILL, MASTER, WASHINGTON STATE GRANGE, SEATTLE, WASH.; GARY SMITH, EXECUTIVE DIRECTOR, INDEPENDENT BUSINESS ASSOCIATION, BELLEVUE, WASH.; AND ROBERT ELLS, CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL ASSOCIATION OF RETIRED PERSONS, VANCOUVER, WASH., ACCOMPANIED BY KARL O. MURPHEY, INDEPENDENT BUSINESS ASSOCIATION

Mr. HILL. Thank you, Senator Gorton.

I am Ray Hill, representing the Washington State Grange, and we represent and now have as our membership over 70,000 in the State of Washington.

I also am a farmer from Klickitat County and have an interest there in a family farm operation.

You have our written testimony that we submitted earlier.

Senator GORTON. The statement will be included in the record.

Mr. HILL. I thank you, Senator.

And in order to be brief, just let me make a few oral comments, beginning with the fact in June of this year the State grange at their convention passed a resolution which is attached to our statement, and it opposed a recent decision of the FTC, and also in that resolution we were asked to write our Congressmen and persuade you to intervene and provide a solution to this issue.

Since that time we have testified at a congressional hearing with Representative Al Swift in Everett this month; we have been present at most of the town meetings throughout the western part of the State. We are concerned principally about the universal service portion of this particular problem, and we feel very firmly that no one should be denied the privilege of a telephone because of costs that they cannot afford. We feel, too, that the telephone is an American way of life, and it should be maintained for all of us.

We are fearful of one thing, and that is that perhaps the telecommunication commission in its decision perhaps may not have evaluated the future impact of its decision accurately. And for that reason we are favorable for the Congress to pass legislation that will protect our universal service concept and to provide the solutions that we feel are necessary.

We commend you in your efforts to do this. We pledge you the support of the grange organization in that effort, and we realize there are several bills now pending. However, we will try to remain cognizant of each of those as they begin to mature and transpire, and we will offer to you our comments as they progress.

I want to thank you especially for the invitation to participate, and we shall be in touch with you in the future.

[The statement follows:]

STATEMENT OF THE WASHINGTON STATE GRANGE

Thank you for this opportunity to come before you today to give our policy regarding the deregulation of the telecommunications industry, the divestiture of AT&T and the resulting impact on the rural community.

The Washington State Grange, with 72,000 members Statewide, is the largest organized group of farmers and rural residents in the State of Washington. Our policy has contained references to the rural telephone system for as long as that system has been in existence. Furthermore, we have expressed concern over the divestiture for the past three years. To say we are opposed to it would be an understatement.

Two months ago, we held the 94th annual convention of the Washington State Grange in Everett. A resolution concerning this issue is attached to our statement. That resolution, in short, opposed deregulation of the telecommunications industry and asked Congress to intervene to stop the deregulation effort and conduct an investigation into the drastic social and economic damage the plan could do to millions of people.

We are convinced that providing telephone service at cost in the rural areas, would drive the cost of just receiving a dial tone beyond affordability. Figures have been presented showing access charges doubling and in some cases tripling due to the loss of income from long distance service. If this were to happen, we can foresee some people opting not to have telephones which would drive prices up even further and eventually put the independent phone companies out of business.

The ultimate solution to this problem must be formulated at the federal level. We are gratified to see the number of bills now being introduced in Congress.

Since any good legislation seems to always change from its original form, we will not comment on the drafts provided to us. Instead, we will supply some characteristics of an equitable solution:

1. We see nothing wrong with the rates for long distance being increased to pay for the privilege of reaching rural residents. After all, the independent companies have, in some cases, expended a great deal of money to update their equipment and to supply service to new rural residents. This should not be considered a subsidy. In other words, we favor preserving universal service at reasonable rates.

2. We are not sure what it will take to reverse the decisions of the Federal Communications Commission and Judge Green, but if the old saying "It'll take an act of Congress" applies here, then so be it. We believe that these decisions are not consistent with the original intent of the Communications Act of 1934.

3. If, and only if, these decisions cannot be reversed, then the multitude of band-aid solutions should be implemented. These include, measured service, pooling the in-State portion of charges on non-traffic sensitive equipment and levying a surtax on long distance companies and big business bypassers of local telephone facilities, the revenue to be used to even out rural phone rates Any law containing such a surtax should be carefully drafted so that there is little chance of these companies "by passing" it and gaining another loophole.

4. Any subsequent regulation of small telephone companies should be kept to a minimum. The Communications Act as now written, exempts small carriers from expensive regulatory requirements. This is good and should be continued.

In summary, the effects of deregulation of the telecommunications industry is not in the best interests of rural Washington. It is in the public interest that universal service, as we have come to know it, be maintained.

Thank you for your attention on this vital issue.

RESOLUTION ADOPTED BY THE DELEGATE BODY OF THE WASHINGTON STATE GRANGE ASSEMBLED IN ANNUAL CONVENTION AT EVERETT, WASH.—JUNE 20–24, 1983

DEREGULATION OF LONG-DISTANCE RATES

Whereas universal telephone service, both local and long distance, is vital to the health, safety and welfare of the people of this country; and

Whereas the Federal Communications Commission plan to deregulate long distance service will cause rates for local service to increase in the range of 25 percent to several hundred percent depending on local circumstances; and

Whereas the compensation for these higher local rates, lower long distance rates, will benefit only large long distance users and large corporations; and

Whereas the state regulatory commissions and the telephone industry itself does not agree that deregulation is in the public interest; and

Whereas deregulation could be financially disasterous to small independent telephone companies resulting in deteriorating or even disappearing telephone service in many small towns and rural areas and the subscribers therein: Therefore, be it

Resolved, that the Washington State Grange vigorously oppose the Federal Communications Commission effort to deregulate the telephone communications industry; and further

Resolved, that Congress be asked to intervene to stop the telecommunications deregulation effort pending a more responsible and widespread investigation to the drastic social and economic damage the plan could do to millions of people; and further

Resolved, that copies of this resolution be sent to the National Grange, the Washington State Congressional Delegation, the Washington Independent Telephone Association, the Washington State Utilities and Transportation Commission and to others deemed appropriately by the Washington State Grange Master.

Senator GORTON. We appreciate your constant participation in this issue all over the State. It is helpful to us.

Mr. Smith.

Mr. SMITH. Thank you, Senator. My name is Gary Smith, executive director of Independent Business Association, and today with me is Mr. Karl Murphey, who has been working with us on this very important issue to small businesses.

If I could start by indicating that small businesses are extremely concerned about the entire issue of telephone service, and small businesses are extremely dependent on available telephone service, not only for the operation of their business, but so their customers can contact them, their suppliers, and their advisers. Small businesses are the most dependent upon the current public system because they are not in a position to individually economically bypass the telephone system as are larger businesses and institutions.

Essentially the FCC is proposing that we go into a cost shift using "end user" access charges and establish these access charges to pay for nontraffic sensitive equipment. This is supposed to reduce the long distance costs, we are told, but I am sorry to report we have not seen any numbers to tell us what the reductions are going to be. In fact, the small businesses that we represent are quite suspect as to how much those reductions will actually be.

The small business access charges proposed by the FCC for small businesses are some 300 percent that of residential rates. Those access charges by the FCC are projected to increase 400 percent over the next 6 years. That is about a 100-percent increase in the cost of telephone service over the next 6 years for small businesses.

Now, the typical small business in 1984 will face about a 30-percent increase just to receive dial tone in their business, and this is not accompanied with any increase in service. What is essentially happening is the interstate-intrastate access charges are being added, and then we have something new charge that has been added here in the State of Washington called common equipment charges. Together, these costs add up to about a 30-percent rate increase in just 12 months, and we are not getting any additional service.

If the long distance rates were to go down, based upon the average small business that we have been able to survey, assuming a business with five lines coming into their business, a 10-percent reduction in long distance rates would require that business to use $526 of long distance toll per month in order to maintain cost parity with current overall costs. A 20-percent reduction in long distance rates, $263 in long distance; 30 percent, $175. Clearly, what we are indicating is they would have to use a sizable amount

of long distance in order just to keep their telephone costs approximately where they are right now.

We have surveyed a number of small businesses in the greater Puget Sound area, and we find that 21 percent of the phone lines going into those businesses have $10 or less in monthly long distance charges; a total of 32 percent have $20 or less in monthly long distance charges; 54 percent, $50 or less in monthly charges; and 73 percent, $100 or less in monthly long distance charges per line.

Essentially what is happening with the FCC order is that the State agencies are following suit with adopting a similar policy. They are also adding a few other things along the way. As I mentioned a little earlier, common equipment charges, which are $11.20 to have the wire terminated in your building for the first four lines. If you have more than four lines, it is $1.40 per line. As you can well see, the cost per line for a small business versus a large business is significantly higher.

Along the way we experienced a 38-percent increase in key telephone equipment costs while most of the other types of telephone equipment experienced very little if any increase in costs.

Intrastate flat rate WATS lines have been frozen in Washington State. Flat rate intrastate WATS lines have been frozen in the State of Washington, so those people that currently have that service can have long distance intrastate toll rates of as low as 6 cents a minute where measured service, which is all there is now available to small business, costs about 30 cents a minute, a difference in cost of five times. If small businesses are to use direct distance dialing, the first minute costs them between 23 and 46 cents a minute, and the second minute costs them between 12 and 31 cents.

What this data indicates is that small businesses are being put into a very anticompetitive position relative to their costs for telephone service because of current State policy.

Now the State is following the Federal Government in the FCC policy.

Quite honestly, what is happening is the disproportionately higher telephone costs for small businesses due to the Federal policy are being seriously compounded by the State adopting a similar policy. We look at S. 1660 as offering a good philosophical alternative that needs clear and careful study. We feel that this could minimize the projected 100 percent increase in costs due to end user access charges for small businesses. We think it bears careful consideration.

S. 1660 will likely minimize the residential disconnect that could occur because of higher telephone costs, and of course, residential disconnects will threaten the ability of small businesses to be able to communicate with potential customers, therefore lower sales, and quite honestly, risk the failure of many small businesses.

S. 1660 proposes to put the burden on those who use long distance. Clearly, from testimony earlier and the numbers that we have provided to you today, there are a lot of small businesses that are not using a great deal of long distance calling but instead will have a significant increase in their costs due to access charges.

S. 1660 would minimize the compounding impacts by State government agencies following what the FCC is doing and creating a

policy that is very costly and quite honestly disproportionately higher for small businesses.

We do support the aspect of competition in the telephone or telecommunication industry, but we feel that we have to, as end users, have an equitable way of allocating those costs. We do support the aspect of bypassers being subject to a universal service charge on an equitable basis so that all companies are competing on an equitable basis.

With those comments, we would like to encourage the Senate to consider this bill. We do not have detailed statistics as to the relative cost impact of the bill. Once those are available, we can take a more definitive position as to our ability to support or not support the bill.

We thank you very kindly for coming to Vancouver, Wash.

Senator GORTON. Thank you very much, Mr. Smith.

Mr. Ells.

Mr. ELLS. Good morning. I am here as a spokesperson for the American Association of Retired Persons—a membership organization of over 14 million older Americans. I am glad to have this opportunity to present the views of AARP on H.R. 3621/S. 1660, the Universal Telephone Service Act of 1983.

IMPORTANCE OF THE TELEPHONE TO ELDERLY CONSUMERS

We are all well aware of the fact that the telephone is a basic tool of modern communication. Ready access to a telephone is important for all consumers, but it is particularly important for older consumers who, as a group, are far more dependent upon the telephone than any other segment of our society. As a result, for older Americans, the telephone takes on increased importance.

This importance cannot be underestimated. The elderly rely upon the telephone as an indispensible tool in relating to and maintaining contact with the world in virtually every facet of daily endeavor.

We rely upon it to summon help in an emergency—to call the fire department to report a fire, to notify the police when danger threatens, to request an ambulance. We rely upon it when seeking advice from the doctor, dentist, nurse, hospital, health clinic, and pharmacy. We use it as a means of seeking consolation from the pastor or member of the clergy in times of grief or mental anguish. We rely upon it as a constant companion, providing us with a convenient connection with family and friends. The telephone affords us the opportunity to stay involved and active even when the weather outside is bad. It allows us to "go out for the evening" even though in actuality we chose to stay at home during the evening as the result of the threat of crime. For many elderly the telephone represents the only social contact with the outside community. It can also be used as a shopping tool—to order groceries, to buy new clothes, to call the plumber.

For the elderly who are of limited mobility or are required by illness to stay at home, the telephone takes on even greater importance. It, in essence, becomes the arms and legs for the immobilized elderly.

For the elderly at the lowest ends of the poverty spectrum, the telephone is oftentimes utilized as the most economical means of communicating.

ELDERLY ECONOMIC SITUATION

According to the 1980 census, the elderly population—those 65 years of age and older—grew by 5 million persons in the 10 years since the last census. The elderly now constitute one out of every nine persons. If all persons 55 years of age and older are included, the ratio of the older group to the total population rises to one out of every five persons. Many of those in the 55 to 65 age group are preparing for retirement, working part time or retired.

Evidence of deterioration in the elderly's income is apparent. The elderly's poverty rate, under the influence of continuing inflation, rose from a low of 14 percent at the end of 1978 to 15.3 percent as of the end of 1981. Additionally, rates of near-poverty—defined as income within 125 percent of the poverty threshold—among the elderly rose from 23.4 percent to 25.2 percent over the same period. Since so many of the elderly—over 10 percent—are concentrated just above the poverty threshold, a drop in income of less than $20 to $25 a week would cause the elderly poverty rate to escalate to over 25 percent.

Other statistics demonstrate how economically vulnerable the elderly are relative to the rest of the population. In 1981 the median income of elderly headed households was only $9,905—less than half the median income level of nonelderly households. In addition, while 50.5 percent of elderly headed households had incomes below $10,000, only 18.9 percent of nonelderly headed households were in this income category. Even adding to the elderly's income the value of inkind benefits they receive cannot change the fact that the elderly, as a group, subsist on relatively low and, in many cases, extremely inadequate incomes.

As to the future, studies done by Data Resources, Inc. [DRI] project that the elderly's share of income relative to that of the nonelderly will decline throughout the remainder of the decade of the 1980's erasing much of the earlier progress. Moreover, if a continuation of current economic trends prompts further cutbacks in Government income support programs, the elderly could soon find themselves in an economic situation worse than that which prevailed 20 years ago when over one-third of them lived below the official poverty line.

AARP'S OPPOSITION TO PRECIPITOUS INCREASES IN RATE SERVICE

AARP's opposition to precipitous increases in rate service should be viewed against the following backdrop. At present, we are beginning to classify the elderly as the young elderly—60 to 75—and the frail elderly—75 to 85 years of age. This latter group is the fastest growing segment of the elderly population due to longevity. It is this group that has the least flexibility with income and the group that would be the most adversely impacted by the proposed rate service increases.

AARP is very much concerned about the rate increases for local service being applied for by the local operating companies, primar-

ily because these proposed rates are so large—doubling local rates at the least and quadrupling them in some rural areas. The chairman of the Michigan Public Service Commnission recently estimated that for every 100 percent increase in phone rates, 10 percent of the people would actually drop phone service completely. For many of the Nation's elderly with incomes below or near the poverty threshold, these increases might well mean widespread dropoff—the giving up of phone service. Such people would simply no longer be able to afford phone service at all.

Such deprivation would of course have its ill side effects: greater isolation of low-income elderly from families, friends from social services, and from their businesses, churches, clubs, and others making up their social network. It is conceivable that the end result of such widespread dropoff might well result in the institutionalization of persons having to discontinue their phone service. Should this occur, taxpayers would be adversely affected.

The local operating companies are arguing that such increases in the rates are an inevitable product of AT&T's divestiture. It is AARP's position, that the local operating companies should provide for greater justification for these increases than they have so far provided.

OBSERVATIONS ON UNIVERSALITY AS PROVIDED FOR IN H.R. 3621 AND S. 1660

The proposed Universal Telephone Service Act of 1983 has the laudable intent of preserving the universality of our national telephone system in both geographical coverage and individual access. Unfortunately, it provides for the financial means to achieve universality only for areas whose local telephone systems incur costs more than 15 percent above the national average. The high costs of service to rural and remote areas would be offset by subsidies from the universal service fund, thereby reducing the rates which local companies in those areas would have to charge to generate needed operating revenue. All consumers, including low-income elderly, would benefit from this provision.

But what of the needs of the vast majority of low-income persons who reside not in high-cost rural areas, but rather in low-cost urban centers? Or those families below the poverty threshold who live in rural areas which do not quite qualify for the fund subsidy? How is universality—defined as individual access to the national phone network—to be preserved for them?

Under the provisions of H.R. 3621 and S. 1660, the responsibility for providing minimum local telephone service at discounted rates for low-income residential customers rests with the State public utility commissions. Conceivably, we are then left with 51 different interpretations of minimum, discounted service and low-income consumers—interpretations which may end up based in part on the resources of the local telephone company. Universality may be a national objective hooked up to widely varying locales.

For that reason, we urge the Congress to provide some guidelines to the States in defining what constitutes minimum phone service. A variety of lifeline or economy service plans already exist, but which ones truly provide universal service at affordable costs to

low-income consumers? AARP would welcome the opportunity to work with you and the Congress in including more specific language in this legislation to define lifeline service.

We are also very concerned that lifeline service may be defined in terms of the resources of the phone company to provide it, rather than on the access needs of low-income subscribers. Just as universal service fund moneys collected at the Federal level would be distributed as subsidies to local phone companies incurring above-average costs, it seems to us that some amount of Federal-level funds should be used to insure that all low-income consumers receive lifeline service, regardless of where they live. The funds needed to guarantee universality in this way need not come exclusively from user charges, but could perhaps be drawn from the proceeds of Federal excise taxes on phone service and channeled to the States.

The lifeline-service provisions of H.R. 3621/S. 1660—if adequately defined and financed—will help assure consumers' access to the telephone system. We support this concept but hasten to add that our support of lifeline service for all consumers should not be misconstrued as support for local-measured-service plans which oftentimes severely curtail phone use by consumers or price its use beyond reach.

AARP'S SUPPORT OF HR. 3611/S. 1660 ON ACCESS CHARGE ISSUE

We are very concerned about the approach taken by the FCC on July 27, 1983, when it approved the imposition of access charges which will be borne by consumers. We are thankful that the FCC modified its decision and did not approve a more drastic version of the proposed access charges that would have adversely impacted even more heavily upon consumers. However, the plan approved by the FCC is still an inappropriate response to the funding dilemma currently faced by the local operating companies. In the first place, the imposition of an access charge inposes a financial burden upon all telephone users before the phone is ever picked up. Therefore, it is conceivable that a consumer who never uses the long-distance feature would be forced into paying for access to a system that he/she will never use.

The FCC obviously recognizes the fact that the imposition of an access charge will adversely affect many telephone users. This is the obvious reason why,.on Wednesday of this week, the FCC made the decision to gradually phase in its recommended access charges. This phasein requires telephone consumers to pay an additional $2 a month, on top of their local phone bill, beginning in January 1984, with the access charge rising to $3 in 1985 and $4 in 1986. It has been estimated by some that after 1986 the access charge could reach more than $7 a month. While this may not seem like a great deal of money to some, it does represent a sizable sum to low income, elderly consumers at the lower end of the poverty spectrum. For these individuals, the imposition of an access charge might well force them into discontinuing phone service altogether.

Rather than arbitrarily imposing access charges as the FCC proposes, AARP feels that the preferable course of action is that proposed by H.R. 3621/S. 1660 which reverses the FCC's decision on

imposing access charges, thus prohibiting the imposition of these additional charges upon all consumers.

COMPOSITION OF PROPOSED UNIVERSAL SERVICE FUND BOARD

The House and Senate versions of this legislation differ somewhat in the proposed membership of the Universal Service Fund Board. The Senate bill specifies that the Board will be made up of five FCC Commissioners and four State commissioners, while the House bill proposes four State commissioners and three FCC Commissioners with Board decisions subject to final approval by the FCC.

We recognize and support the critical role to be played by both the FCC and the State regulatory commissions in the implementation of this legislation. However, we believe strongly that the State commissioners should comprise the Board majority, given their responsibilities in insuring universal coverage to consumers, and that Board decisions should not be subject to FCC approval.

NEED FOR DATA TO EVALUATE RATE PROPOSALS

Members of AARP, along with other consumers, have found themselves at a disadvantage in evaluating the rash of rate requests by operating companies, including the proposals to establish local measured service. We realize that these are matters outside the purview of this legislation and these committees, but we think the committees could oversee the collection and organization of necessary data better than it can be done at the individual State level.

The following kinds of information or guidance are necessary:

First, as mentioned earlier, we feel there is a need for the Congress to provide to the States a definition of what actually constitutes lifeline service. Such a definition is essential in order to avert wide disparity in the inevitable varying of lifeline service from State to State;

Second, we would like to see a compilation on a State-by-State basis that indicates the present existence, the extent and variety of lifeline or minimum basic telephone service systems in the United States;

Third, we would also ask the two committees involved in these hearings to request that the Congressional Research Service, or some other appropriate governmental organization, to look at the various telephone rate structures in use across the country in order to devise a model-rate structure that could then be used in the individual States. This would be a tremendous help to consumers in all of the States as they deal with their respective public utilities commissions concerning possible changes in telephone rate structures. Such a study would have to be undertaken as soon as possible since such changes are currently under consideration in many States.

Senator GORTON. Thank you very much, Mr. Ells.

Mr. Smith, you may have answered the question which came to me as you were going through your testimony. You made a good statement of the general principles of the organization that you represent, but I gather at this point you do not have enough knowl-

edge about any of the specific bills before Congress to take a position on them?

Mr. SMITH. Unfortunately that is true, Senator. We are spending essentially all of our resources just trying to keep up with what is going on at the State level, and Mr. Murphey was brought into the firm for that purpose. And I am sorry, we have not had time to do both.

Senator GORTON. But at least you would like us at least to apply the principles you outlined to any legislation we consider.

Mr. SMITH. Please.

Senator GORTON. Mr. Hill, I would like to ask you the question I asked of the heads of one of the smaller telephone companies, and that is what justification is there for having Congress intervene with Federal legislation to keep basic telephone service rates for rural customers lower than they are for people in cities?

Can you answer that question for me?

Mr. HILL. Senator, I think that there are some basic principles that we have in life, we have in the United States that more or less delegate that we do certain things for different classes of society, and for instance, I am not sure about the Communications Act of 1934 that was passed, but my understanding is that that act more or less delegated the fact that we provide this kind of universal service to all people, regardless of class, creed, color or whatever society or part of society they belong to.

And I guess our philosophy is that we believe strongly, and the Grange does, that we need some of the basic necessities of life, energy, communications, and some of those things we think necessary.

Senator GORTON. Thank you.

Your written testimony went on to state that the Grange favors a tax as the basis from which to fund universal service.

Do you mean that you prefer a tax to the kind of bypass charge and long distance charges proposed in some of the bills before Congress, or does that really mean that you just simply want to see to it that we have a proper funding mechanism?

Mr. HILL. I think that one of the first statements we made was that we said that, for instance, we see nothing wrong with the rates for long distance being increased to pay for the privilege of reaching rural residents, and I think if that is a necessity, if that is one of the alternatives that we face, that we believe that that is a tradeoff that we might have to accept. But we will not, I think, in our primary and priority is that we provide service for all of our people at as reasonable a cost as we can get. And if it has to be subsidized in some way, then, that is one of the things that we would favor.

Senator GORTON. Thank you very much, Mr. Hill.

And Mr. Ells, I think everyone who deals with this issue would agree with the proposition that it is unacceptable to have people, especially the elderly, do without phone service because of rising costs. I would like to know why you and why AARP prefer a broad approach that covers far more than those in need, like the approach of reversing this FCC decision, rather than a targeted form of subsidy that would look directly at the needy, the elderly, or people in rural areas.

Do you have a strong reason for taking the position that you prefer the broad reach rather than the targeted program?

Mr. ELLS. As far as I know, I could not answer that too specifically, but I think one of the reasons they would like to go this route is the means assessment, keep away from something like that, not so you would have to get down, if you are making *x* amount of cents, you can have this, and you can have that. I think that is wrong. And I think that comes home very true in some of the other aspects of senior activities that I am particularly involved in such as Southwest Washington Area Agency on Aging Advisory Committee. We monitor the aging contracts and stuff that our local area agency on aging works out, and we assess the work that the providers are doing. And in doing this, we go into homes, and it would just surprise you the amount of homes you go into that their income level is between $200 and $300 a month, and these people kick the figures around of a raise of $2 or $3, and maybe $2 or $3 next year and on down the line. This is going to put these people clear out of the phone system because there are a few things that they have to have. They have to eat, they have to have heat, they have to have whatever, and $200 does not make a great impression on that.

So they have to give up something, and I was sitting at the breakfast table this morning, and I looked over at the phone, and there was a number up above the phone, and it said 911. And that is our emergency service number down here which we are very proud of, and I would hate to see anybody priced out of the phone system so they could not use that.

Senator GORTON. I thank you. I think that probably summarizes the goals of this hearing and of all of the people who have been here.

So I should like to thank this panel for its contribution toward the solution to a very difficult problem.

This is a problem, I would like to say to all of the people who are in the audience today, which is emergent. The order with which we are dealing goes into effect on the first of the year. Any action the Congress is going to take will have to be taken promptly.

For that reason, and because it is necessary for us to have as broad a base of knowledge and facts as possible to deal with the issue, we will keep the record of this hearing open until approximately the 15th of September. If any person in this audience wishes to contribute a written statement of views to this subject, they are welcome to do so, and such statements will be made a part of the official record.

They should be sent to the Senate Commerce Committee, Washington, D.C. 20510.

I will announce now that we do have a statement here of Commissioner John Lobdell of the Oregon Public Utilities Commission which will be included in the record.

The ability to have your views known and to be made a part of the record is one which will apply to every citizen who wishes to contribute.

The challenges that we all face I aim to maintain and strengthen the principle of uniform telephone service, to restrain unwarranted increases in the cost of telephone service to any person, to encour-

age technological innovation and new and more efficient ways of communications, and to enhance competition for the benefit of all of our citizens. These are all worthy goals, they are all vitally important goals. They are sometimes difficult to reconcile with one another, and the very number of bills before Congress illustrates how many different ideas there are about how we can reach those goals.

We do want as much help as we can get. I am very grateful for the time invested in this hearing by all of the people who have contributed to it.

With that, the hearing is adjourned.

[Whereupon, at 12:07 p.m., the committee adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF GARY L. CONKLING, MANAGER, GOVERNMENT RELATIONS, TEKTRONIX, INC.

Senator Gorton and Senator Packwood, it is a privilege to submit this testimony today on a subject of far-ranging importance to Americans—national communications policy.

It is important to begin with an acknowledgement that the United States has a superior, world-class communications network. That network has yielded a bounty of social benefits, not the least of which is an efficient, affordable communication system which Americans of all economic and social classes can and do use.

But that network has been important for another reason—it is part of America's commercial and industrial infrastructure. Much more than we realize, our communications network has knitted together abundant economic opportunities which have produced literally millions of jobs.

That has never been clearer than now. As we enter the Information Age, our society will be judged not only on its transportation system, schools and energy resources, but also on its communications network.

IMPACTS ON INDUSTRY

Many witnesses at this hearing, and other hearings around the country and in Washington, have emphasized the complexity of the issue before you.

Considerable stress has been placed—and properly so—on the social impacts of higher telephone rates resulting from deregulation of the communications industry.

My goal will be to focus your attention on the equally serious impacts on America's industrial users, especially the emerging high technology industry.

Without question, ill-advised national communications policies could hinder the development of high technology industry in the United States. There is a direct link between development of high technology products and development of modern communications devices and networks.

BACKGROUND ON TEKTRONIX, INC.

Tektronix, Inc. makes a wide and expanding line of high technology tools for technical users such as engineers. Our products are used in research, design, production and testing of just about any product or system there is, from radar to television broadcasting to research computers. Not surprisingly, our equipment is also invaluable for manufacturers and operators of telephone and data transmission equipment.

We are one of the two largest manufacturers of test and measurement instruments in the United States and one of the largest in the world. Our sales in 1982 totaled $1.2 billion.

Despite our size and our commanding market share in many product lines, Tektronix remains vulnerable to recessionary impacts in the United States and around the world. We also are a prime target for foreign competition in the test and measurement field.

TEKTRONIX TELECOMMUNICATIONS SYSTEM

With more than 17,000 employees in Oregon and Southwest Washington, Tektronix operates a privately owned telecommunications complex that has both voice and data capability. It is a capital asset worth more than $20 million.

It costs Tektronix almost $8 million annually to maintain and run its own telecommunications complex. And, in addition, Tektronix pays more than $7 million annually to the Bell System and General Telephone to lease telephone systems and for

local and long distance service. Our daily average telecommunication bill runs $41,000.

Clearly, we have a huge stake in national communications policy, especially in terms of cross-subsidy mechanisms designed to provide affordable universal service and lifeline rates for the very poor.

And while your attention has repeatedly been drawn to bypass strategies of large industrial and commercial users, it is perhaps helpful to understand why we invested so much money in our telecommunications system.

The answer, simply, is that common carriers were unable to provide communication services that were large enough or reliable enough to support our huge force of design engineers. (It also didn't hurt, incidentally, that our own telecommunications system yields us a greater degree of control on the security of our data transmissions, many of which contain highly proprietary information.)

In our opinion, neither Pacific Northwest Bell nor General Telephone could offer a system today that could meet the capacity, access flexibility, data rates, total system throughput or other operational and maintenance capabilities that Tektronix needs, and those needs are accelerating at almost geometric rates as technology advancement quickens in our industry.

Whereas data transmission is only a small part of the traffic handled by our nation's common carriers today, data transmission for Tektronix is a staple of our everyday engineering design life. A full 20 percent of our 44 megabit microwave facility is consumed by data transmission to support our engineering force. That percentage is leapfrogging every year.

In short, we didn't spend $20 million on a telecommunications system just to beat the system and avoid paying higher prices for telephone service. We spent that $20 million because it was the only way we could make available a telecommunications system that met our demanding industrial needs.

Our microwave system reveals our true intent in bypasssing the common carrier system. We installed, at greater expense, a digital microwave facility which gives us the ability to handle both voice and data transmissions. If our goal was simply to save dollars on voice transmission, we would have only invested in an analog microwave.

But our goal was as I indicated earlier—to provide a state-of-the-art telecommunications system that we needed and that wasn't available anywhere else. Let me give you an example:

If we used available common carrier data service to support one of our new computer terminal products, it would take almost 2 hours to transmit 1 screen of graphics information. On the Tektronix microwave system, the same function only takes 43 seconds.

For similar technological reasons we are pursuing broad-band cable development, both on our own and in conjunction with commercial cable operators. Broad-band cable, in addition to providing greatly expanded capacity, also meets our industrial demand for multiple-function systems—in this case systems with the ability to support education-at-home, work-at-home and direct vendor supply, repair and financial services.

IMPACT ON TEKTRONIX PROFITABILITY

To design leading-edge products and manufacture them cost-competitively in a world market increasingly requires advanced data processing and telecommunicatcns facilities.

Rapid shifts in market demand require a great degree of flexibile access to computing and engineering support tools between our plant sites and high volumes of information transfer to accomplish these tasks.

New product development is critical to Tektronix continued success in the high technology marketplace, which has pronounced short life cycles for products—typically three years.

To support shortening development cycles, Tektronix has invested millions of dollars annually incomputers and software tools to realize Computer-Aided Design/Computer-Aided Manufacture economies of scale.

Frankly, this strategy is based on the decreasing costs of data processing and storage hardware, and on a flexible but affordably priced interconnecting communications network. Any major increase in the telecommunications support costs—especially costs unrelated to improved productivity—will cause Tektronix to rethink this corporate strategy. Read that as rethinking the future growth patterns of Tektronix, not only in Oregon and Southwest Washington, but in the United States.

OUR PRESPECTIVE ON NATIONAL COMMUNICATIONS POLICY

This is our position relative to national communications policy:

We support policies that encourage and reward competition in the telecommunications industry.

We support the court-ordered decoupling of local and long distance carriers. This is vital if emerging local service technologies are to be fully tested and reach their full competitive potential.

We oppose taxing private data networks since they provide services that are not available from traditional vendors. We also oppose the Federal Communication Commission's proposed access charges.

We recognize the opportunity to create a successful business occurs in a larger context. The world has become far too small, and its parts too interelated for us to set objectives without being mindful of their effect on others. As a local, a national and a global citizen, we must continually keep abreast of the social, political and economic strivings of those about us. Consequently, we support the concepts of lifeline and universal service.

We believe that if cross-subsidies to support universal coverage or lifeline goals are imposed they should be attached to companies providing long distance telephone service. Long distance technologies are relatively mature and a subsidy won't retard their further development.

If subsidizing taxes must be imposed on private voice systems, those taxes should be imposed only on service that is truly equivalent with common carriers (including such factors as security, installation and repair responsiveness and interconnectivity). The rate of tax also should be adjusted to take into account the private enterprise's cost of service.

SUMMARY

In conclusion, Tektronix believes national communications policy is correct in separating local and long distance carriers.

The long distance market is highly competitive and the technologies to be used have been identified and are being developed.

Local service markets are yet to be defined, as are their technologies. A pro-competitive atmostphere, as free as possible from over-regulation and from restraints with the single view of holding down rates, will promote technological development that will begin to define local market service in the next decade—and the next century.

Policy-makers such as yourself and regulators at both the federal and state level must be keenly aware of the repercussions of your decisions not only on telephone ratepayers, but also on U.S. companies and workers—especially those involved in the competitive high technology industry.

We will gain little in preserving low telephone rates if, in the process, we sacrifice our nation's private sector ability to achieve new economies of scale and world competitiveness through use of modern telecommunications networks.

Our real goal for national policy must be an amalgam between an affordable telecommunications network and a flexible, technologically expanding telecommunications network. For example, it no longer will be acceptable to insist on long depreciation schedules for new telecommunications equipment to hold down rates because emerging user demands will dictate quicker turnover of equipment and entire technologies.

Finely crafted compromises will be necessary. We are counting on thoughtful Senators such as you to make sure compromises made today stand the test of time tomorrow.

STATEMENT OF JEANNINE THOMPSON, KING COUNTY MEDICAL COMMUNICATIONS CENTER, INC.

Let me begin to thanking the committee for this opportunity to submit this statement for the record of your hearings on universal telephone service and the impact on this policy of recent Federal Communications Commission actions. While I can speak only for my own business, I believe my concerns are fairly representative of the nearly 5,000 telephone answering bureaus in the United States. We are small businesses ourselves, providing a vital, often lifeline, service to the medical and small business communities. The way in which telecommunications policy is taking shape, particularly the issue of access charges, raises many questions for the tele-

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phone answering service industry. How these policies will be implemented and impact our industry is unclear, but that impact could be devastating.

By way of background, let me state that I am President and Manager of King County Medical Communication Center, Inc. in Seattle, Washington. My company is a telephone answering service (or TAS) and radio paging company serving some 1,200 members of the medical community in the greater King Country area. This clientele includes doctors, dentists and 24 hour a day crisis hotlines. King County Medical Communication Center was established in 1926 and employs some 50 people.

I might add that while my bureau serves the medical community exclusively, most telephone answering services support small business and commercial accounts as well. In many cases, the availability of quality, live telephone answering service is as crucial to these businesses as the service my bureau provides is to the health and well being of my doctors' patients. Often, the communications support provided by a TAS which eliminates or reduces the need for maintaining an office and staff of their own is decisive to the viability of a small business.

Attached to this statement is a brief paper prepared by the trade association which represents the TAS industry and describes how businesses like mine provide service to our customers. You will notice that while there are a few different technical means of connection to my customers, TAS bureaus reach and serve our clientele via the public telephone network.

In fact, my trade association, Associated Telephone Answering Exchanges, tells me that businesses like mine pay more than $100,000,000 a year to the Bell System telephone companies alone for the lines, services and equipment we use to reach our customers. Those customers also pay both one time installation as well as monthly service charges directly to their serving telephone company for their connection to a TAS. And, finally, the telephone answering service industry enhances the efficiency of the telephone company's network operations and increases their revenues because TAS bureaus complete calls which other wise would have gone unanswered. A Bell System spokesman was quoted in 1979 as saying that "improving the nationwide call completion rate by only 1 percent would result in $160 million in additional revenues" for the telephone companies. In 1959 AT&T estimated that telephone answering service accomplished call completion resulted in additional revenues to the Bell System amounting to some $10,000,000! AT&T has not provided similar data for a more recent year.

Suffice it to say we, the telephone answering service industry, are major customers to the telephone companies. We make significant use of the local, switched telephone network to provide vital communications support to the public we serve and we pay dearly for this network use. Typically, 15 to 20 percent of an answering bureau's cost of doing business are telephone company charges.

Which is why our industry is so concerned with pending changes in ratemaking practices. I understand that the soon-to-occur break up of the Bell System, combined with deregulation and the growth of competition in the long distance service market are forcing a change in method in which telephone companies, particularly the local telephone companies, recover the costs. What remains unclear is how or if the access charges now being created to replace the traditional separations and settlements process will be applied to the lines and facilities my bureau uses to serve my customers.

Application of these charges to each customer I serve would be ruinous to my business; moreover, it would be grossly unfair. Let me tell you why.

The lines and facilities which connect my telephone answering bureau to my customers are not used to place calls of any sort, local or long distance. There are receive-only facilities, used by my operators to answer calls on my customer's phone lines. These lines are also not, directly, used to receive interstate calls. You do not call the answering bureau to leave a message for one of my customers. You call the customer's number directly. The answering service, literally, is only an extension phone on that line. My customers will already be paying an access charge on the line I answer. To exact that charge again on the line which provides an extension of his basic phone service line to my bureau would be double dipping.

A certain part of the customers I serve (a little less than a third) are connected to my bureau via concentrator-identifiers and call forwarding (both are described in the attachment, "How Answering Service is Provided") with both of these methods, traffic for a larger number of customers is funnelled over a smaller number of trunk lines. You can make the analogy of a party line for these facilities. Up to 100 customers might be connected to my bureau over six concentrator trunk lines. A similar ration is typical for the number of lines which carry call forwarding customers' calls to my bureau. Is an access charge to be made on each of those clients?

That would result in recovering the charge 100 times on six trunk lines, as well as on each of the customer's own basic phone line.

It is my understanding that the idea behind the access charge plan is to provide a means of recovering for the local telephone companies the cost of originating and terminating interstate calls. The lines and facilities used by telephone answering bureaus to connect with their customers are an adjunct to, not an integral part of, that local/long distance network. They are separate and apart, and are, in fact, treated like private lines in most state tariffs. Their costs are recovered through rates established specifically for these unique categories of service.

I must admit I am no expert on and am more than a little confused by the extraordinarily complex issues involved in the policy debate regarding access charges. I have heard compeling arguments for having the access charges paid by the long distance carriers, and for having them paid by the end user. I frankly don't understand the issue well enough to have a firm opinion either way on that.

I do, however, have a real fear over broad and sweeping generalities about the application of access charges which make it sound like they are going to be applied across the board, even to facilities which are not a part of the telephone company plant involved in the provision of point to point local and long distance messaging service. TAS are not a link in that chain which makes possible the origination and termination of interstate telephone traffic, or even intra state long distance and local telephone traffic, for that matter. We are something different and to the side. An add-on, if you will. We are willing to pay our way, and I believe we are. The rates we pay for the telephone company provided services we use are regulated at the state level, and based on costs, as presented to the commission by the telephone company.

The FCC, in its access charge order (Third Report and Order in CC Docket No. 78-72, Phase I) clearly allowed for exceptions in its rules for "facilities used for services that are not close substitutes for MTS" (at paragraph 3). I believe that fairness dictates that TAS facilities be acknowledged as one of those exceptions to the rule. I would urge that any action taken by the congress include a definite statement to that effect.

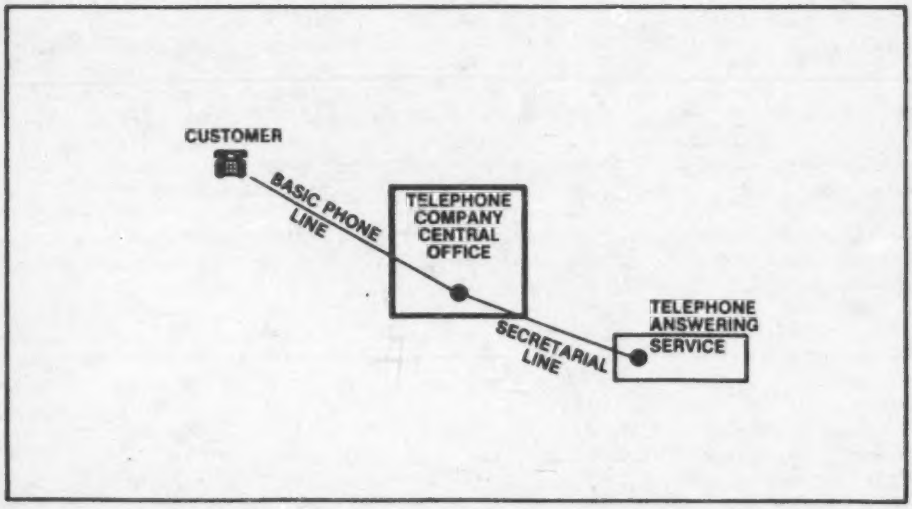
HOW ANSWERING SERVICE IS PROVIDED

The telephone answering service industry consists of private, independent service bureaus; the facilities used by the bureau to make answering service possible are those of the local, wireline telephone company. Telephone company provided secretarial lines and concentrator-identifiers are the traditional means of providing answering service. Those wiring arrangements are described below, along with discussion of terminal equipment and new technology developments in telephone answering.

THE SECRETARIAL LINE

The so-called hard wire secretarial line is the historic manner in which TAS bureaus have provided service to customers, whether business or residential, when that customer is served by the same telephone company central office (co) as the TAS bureau. This service arrangement can be pictorially represented as follows:

FIGURE 1



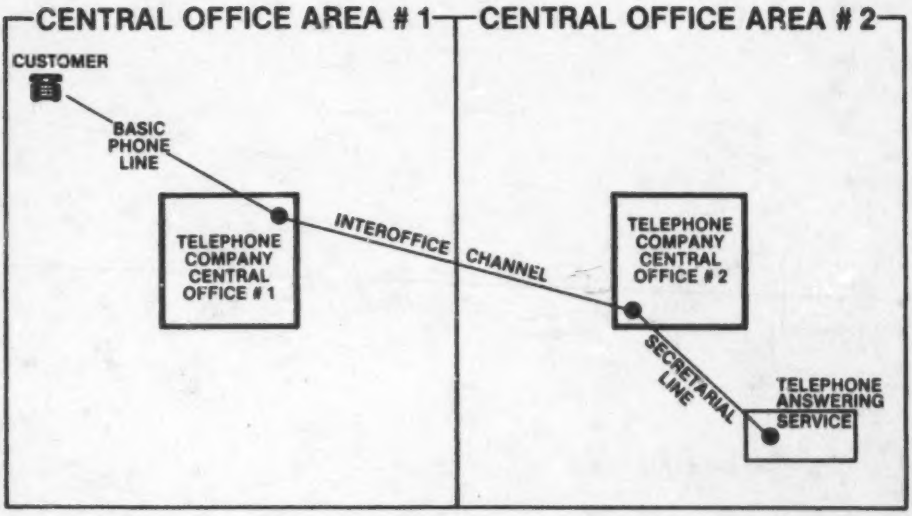
The telephone line running from the customer's premises to the telephone company central office is the line by which the customer receives basic telephone service (business or residential), sometimes referred to as POTS (or plain old telephone service). The secretarial line running from the telephone company central office to the TAS bureau is connected by a jumper wire to the customer's basic phone line on the main distributing frame in the central office. In essence, the secretarial line provides a physical extension of the customer's phone at the TAS bureau: when the customer's phone number is dialed, the call rings at both the customer's premises and the TAS bureau. Either party may answer the line.

The customer, not the telephone answering bureau pays a monthly charge to the telephone company for the secretarial line. In addition to the monthly recurring charge, the telephone answering service customer must also pay a one time installation charge to the telephone company at the time the jumper wire connection to the secretarial line is made on the central office main fame. These telephone company charges appear as part of the customer's regular telephone bill.

THE CONCENTRATOR-IDENTIFIER

Particularly in metropolitan areas with more than one telephone company central office (or local exchange), there may be customers desiring telephone answering service who are located in different telephone company central office areas than the TAS bureau. TAS bureaus originally provided answering service to customers in different central office areas by means of the hard wire, secretarial line connection described above. This, however, necessitated that an interoffice (or foreign exchange) line be dedicated to service, extending from the central office in which the customer was located to the central office in which the TAS bureau was located, in addition to the local channel.

FIGURE 2

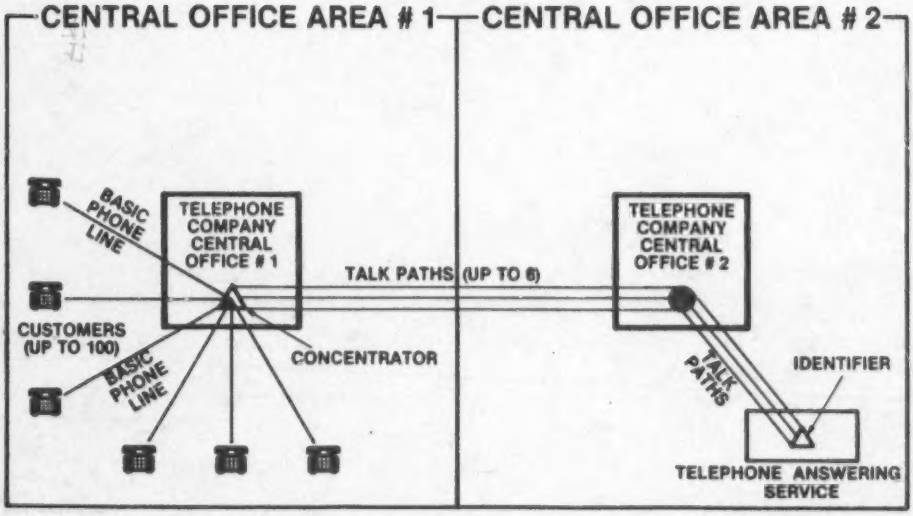


This was a very costly and inefficient manager of providing service because it tied up expensive interoffice plant facilities. Therefore, two pieces of equipment which work together as a system were developed by the Bell System and offered to the TAS industry in order to allow TAS bureaus to more efficiently serve customers in different central office areas. The so-called Concentrator-Identifier system (or C–I) has now been in use by telephone answering services for many years. The Bell System has encouraged the use of this equipment since it eliminates the necessity of extending an individual dedicated line for each customer in the different central office area. This has obviously been good for the Bell System since they have not been required to make the investment in these costly interoffice dedicated lines. It has been good for the telephone answering services since it has allowed them to provide service to more customers in a larger area and it has been good for telephone answering service customers because it has made it possible for them to receive a service that they need or desire and which otherwise would have been to expensive to provide.

The concentrator half of the concentrator-identifier system is located in the distant Bell telephone company central office. The TAS bureau's customers (up to 100 in number) are connected to the concentrator. Up to six connecting channels (called talk paths) extend from the concentrator in this distant central office to the central office which serves the TAS bureau. The same number of talk paths run from this central office to the identifier half of the C–I system, which is located on the TAS bureau's premises.

The concentrator acts like a funnel, channeling the 100 customer lines into the six available connecting channels which carry the calls to the TAS bureau. The identifier, as the name implies, identifies which of the 100 customer's line is ringing in to the bureau on one of the 6 trunks.

FIGURE 3



The concentrator-identifier system is manufactured by Western Electric and supplied to TAS bureaus by the Bell Operating Companies. The two halves of the system function only in conjunction with each other. This is electromechanical equipment of an old vintage.

Telephone company charges for the C–I connection is borne in part by the TAS bureau and in part by the customer. The TAS bureau pays the telephone company each month for the concentrator-identifier system. Referring to the diagram above, the TAS bureau also pays a monthly recurring charge to the telephone company for the talk paths which extend from central office No. 1 to central office No. 2 and on to the TAS bureau. In addition, the TAS bureau also pays the telephone company a one time installation charge for the equipment and talk paths.

Even when a telephone answering service uses a concentrator-identifier, the telephone answering service customer must also pay an installation or initial nonrecurring charge at the time he institutes service and a monthly recurring charge to the telephone company. That charge is presumably for a connecting wire which would extend from the customer's position on the main frame in central office No. 1 to the concentrator, also located in central office No. 1.

THE TELEPHONE ANSWERING SWITCHBOARD

The traditional vehicle which telephone answering service bureaus have used to answer incoming calls (on both secretarial line and concentrator-identifier connections) are switchboards, manufactured by Western Electric and supplied to the TAS bureau by the Bell Operating Companies. While there have been a number of different models of switchboards, they are all of the same basic technological vintage. The 557B switchboard has been most widely used, and has been the basic piece of equipment which the Bell System has offered to telephone answering services for many, many years. It can be described as a manual cord switchboard which can easily be visualized by remembering the old switchboards which "Central" used in the old time movies. One hundred lines might extend from the telephone company central office to the telephone answering service in a cable (the secretarial lines) and then each of those 100 lines would be wired into the individual positions on the switchboard. When a call comes in on one of these secretarial lines, an indication appears on the switchboard that the line is ringing and the telephone answering service operator can answer the call by inserting a plug into a jack associated with that line.

This is extremely old vintage equipment and many of the estimated 10,000 switchboards now in use have been in place in telephone answering services across the United States for many, many years. Numerous telephone answering service witnesses have stated in their testimony before state regulatory commissions that the 557B switchboard is, in fact, the oldest unmodified piece of equipment offered in the United States by the Bell System. That testimony has not been challenged.

The electromechanical concentrator-identifier functions only in connection with this older vintage, telephone answering service switchboard.

NON-BELL TELEPHONE ANSWERING EQUIPMENT

Within recent years, a number of non-Bell vendors have developed newer vintage telephone answering systems. The newer vintage equipment is of an entirely different technology then the existing manual switchboards and concentrator-identifiers, employing micro-processing computer technology and (often) video terminals. These systems can be generally classified in two generic types: private concentrator systems and DID/call forwarding systems. (Hybrid systems, combining the two generic types are also becoming available.)

While there are many attractive features in these new, state-of-the-art offerings, the rules and regulations of the Bell System, rate practices of the operating companies, technical requirements on the connecting central office and system-size restrictions all have severely limited the viability of non-Bell equipment for many answering bureaus. The needs of the TAS industry and the availability of viable alternatives vary widely from state to state, but in many areas and for many TAS bureaus, the Bell provided, antiquated switchboard and concentrator-identifiers are the only equipment which will work. In reality, the telephone answering service industry in many areas of the country finds itself a captive customer of the Bell System not only for lines and services, but for terminal equipment as well.

PRIVATE CONCENTRATOR SYSTEMS

Non-Bell electronic concentrator systems function similarly to the Bell, electromechanical concentrator-identifier described above: a large number of customers are wired to the concentrator, which funnels the calls along a smaller number of trunks, which carry the calls to the TAS bureau. While the Bell concentrator is physically placed inside the central office, however, the Bell System has refused to allow concentrators supplied by other vendors inside the telephone company CO. A TAS bureau using a private concentrator, therefore, must sustain the additional cost and many other practical difficulties involved in purchasing or leasing space near each central office to house their concentrators. Of even greater significance is the fact that because the concentrator is outside of the central office, customer connections to it must be made via hard wire secretarial lines running from the customer's position on the main frame inside the central office to the external concentrator location. In most cases, these lines are many times more expensive than the simple connection to a concentrator inside the central office available with a Bell-provided, electro-mechanical C–I, greatly reducing the viability of this type of equipment.

AT&T'S GENERAL PURPOSE CONCENTRATOR

AT&T has been endeavoring to develop and introduce its own state-of-the-art, electronic concentrator. This so-called "General Purpose" concentrator will be located inside the central office but, unlike the electro-mechanical C–I, it will be able to connect, to any computerized terminal system at the answering bureau's premises. The General Purpose concentrator is not yet readily available and many in the industry question whether it will be a practical alternative because of the proposed pricing concepts.

DID/CALL FORWARDING ANSWERING SYSTEMS

If a TAS subscriber is served by a telephone company central office which provides the Custom Calling Service of call forwarding, and if the TAS bureau is able to obtain direct inward dialing (DID) numbers in bulk from the telephone company, an arrangement is possible that eliminates the necessity for hardwire connections at the telephone company central office.

A customer with call forwarding can "program" his telephone so that all incoming calls are redirected to an alternate number. DID numbers are, essentially, telephone addresses. They are phone numbers which are not associated with any phone whatsoever but serve as a destination point for calls routed down trunk lines. The TAS bureau leases DID numbers in bulk from the telephone company and assigns one of these numbers to each customer. When the customer wishes to have his phone answered by the bureau, he merely forwards all calls to that DID number.

The use of this method of operation is limited to areas in which Bell electronic switching systems are in place in the central office, making call forwarding and DID technology available. As a practical matter, a TAS bureau operating in a large met-

ropolitan area cannot use call forwarding technology unless all the central offices in the market area the bureau serves have this capability.

Even in larger cities, such as Chicago, the electronic switching development has been sporadic. Many smaller cities will not have electronic switching offices until well into the next century. This crucial factor limits the viability of this very attractive means of providing answering service.

Where answering bureaus do utilize this method of service, the monthly cost of the Custom Calling call forwarding feature is paid to the telephone company by the customer. The answering bureau pays both a one time installation charge (sometimes called a "system charge") and monthly recurring charge to the telephone company for the blocks of DID numbers, and special trunks which carry the forwarded calls from the central office to the TAS bureau location.

STATEMENT OF MICHAEL D. WOODY, DIRECTOR OF TELECOMMUNICATIONS, DEPARTMENT OF GENERAL ADMINISTRATION, STATE OF WASHINGTON

Senator Gorton, my name is Michael D. Woody. I am director of telecommunications for the department of general administration of the State of Washington. I appreciate the opportunity to testify today on the issue of universal telephone service. My objective is to present a telecommunications manager's perspective on the issues at hand; this viewpoint is seen as one from within the State government of Washington.

Within the State of Washington, the State government is the largest single consumer of telecommunications goods and services. The State provides, on a shared-use basis, a statewide network which offers long distance services to State agencies and other political subdivisions at a cost far below these same services could be purchased directly from the local telephone companies. There are over 550 agencies, 220 locations and 100,000 users on the network. It includes all State agencies, and most county and city governments, fire districts, port authorities, Indian tribes, school districts, libraries, public utility districts, transit systems, and all community colleges and universities. The net effect of the State's network is that the cost of communications within all levels of government is reduced. The ultimate benefactor is the taxpayer.

In its use of telecommunications goods and services, the State government of Washington shares the concerns and objectives with the private business sector. Namely, we both strive to procure and operate systems that are efficient and cost effective for our users. The State is not unique in how it tries to meet the business requirements of its using agencies. To date, most network services operate through the local exchanges network and the local utility companies. There are some unique requirements, however, which are best provided through what is referred to as bypass techniques. It is the issue of bypass that is my concern.

In some instances, the State is a bypasser of the local switched network. There are some governmental functions where bypass is the normal mode of operation. The State's department of emergency services needs a network in place that can be relied on to function in cases of natural disasters. For example, when Mt. St. Helens violently erupts, the public is advised, through the emergency broadcast system, not to use the public telephone system unless it is absolutely necessary. The public network was not designed to function in these overload or disaster situations. Yet this is the very time that the department of emergency services must function, that it must have the full availability of a network; and this is why they must bypass the local exchange.

The State's department of natural resources uses private microwave facilities to monitor forest fires within the remote wilderness areas of the State; areas on mountain tops where there are no local exchange facilities. Likewise, the department of transportation has an extensive private microwave system that is used primarlily for mobile radio dispatching of highway maintenance and repair vehicles; the department has private circuits installed for remote control of highway weigh station signs and mountain pass signs relaying weather conditions ahead as closure information during the snowy winter months. The Washington State Patrol uses private mobile radio for law enforcement and has a rather extensive microwave network dedicated to its support. Obviously, there are many other lifeline type services, such as 911 dispatching, that use private radio systems as well.

All of these services would fall into the category of bypass under the definitions of the proposed legislation. In providing many public services and governmental functions bypass is an absolute requirement; in providing others, it may only be an economic alternative. Our concern in the bypass issue revolves around the underlying

assumption that there is something intrinsically wrong with it. From a telecommunication manager's perspective, this notion is difficult to reconcile with my perceived essential job function. It is my job to make the network and systems cost effective and efficient; to take advantage of technology and competition by optimizing where economically feasible.

I am concerned that bypass is treated as an undesirable and should, therefore, be discouraged, not encouraged; that this discouragement will affect competition and technological advancement, and ultimately, the taxpayer.

Senator Gorton, I am neither a lawyer, an economist nor a policy maker on telecommunications matters within the State of Washington; I am a manager of a large telecommunications network. As a consumer I can appreciate that the matters before you are extremely complex. They involve technical telecommunications issues and serious matters of public policy that have developed over the past 50 years. The issues involve a grave concern over the rapid rise of local rates and the threat to universal service. They involve the establishment of a fund to insure these goals. The issues are not simple; neither are the solutions.

I would suggest for your consideration that Congress mandate a comprehensive investigation clarifying some of the gray areas that need further definition—one of these being the issue of bypass. Then, After all the issues are thoroughly examined, with input from all sectors of the telecommunications industry—consumers, providers of service and regulators, then proceed with legislation that clearly addresses the major problem areas.

Senator GORTON. I would like to express my appreciation for the opportunity to share with you some of our concerns on bypass, and would be willing to pursue them further in the question and answer session to follow.

STATEMENT OF CONTINENTAL TELEPHONE OF THE NORTHWEST

INTRODUCTION

This Special Legislative Briefing is designed to help you present to your Congressman Contel's point of view on the many legislative initiatives conceived by their authors to address the vexing problem of maintaining "universal service".

The definition of universal service is so widely construed that it defies consensus. In the Communications Act of 1934 appears the statement "so as to make available, so far as possible, to all of the people of the United States a rapid, efficient, nationwide and world-wide wire and communications service with adequate facilities at reasonable charges."

Nowhere in the Act is it stated that there is be "universal" service in the sense that it is an entitlement, nor is there a distinction between classes of users, nor is it stated that a service must be provided to customers at a charge that is below actual cost, thus denying carriers a fair return on their investment.

Universal service is a good business goal since the more subscribers there are, the more use will be made of the transmission systems and the better the return for the seller. This is no different than any other commodity offering in that sense. The bulk of telecommunications services is exactly that, a commodity offered for public use by publicly-held companies.

Universal service is a worthy social goal as well. The basic social need to communicate and the ability to obtain help in critical situations are of inestimable value.

Then why question "universal service"? Simply because telecommunications, as a commodity, is a product whose sale and purchase are basically subject to market forces. Under an integrated network operating in a monopoly situation, the total income from virtually all suppliers of telecommunications services could be pooled and distributed quite easily to subsidize any one class of subscriber. For this industry, it was decided by appropriate authority that toll subscribers would essentially subsidize residential users. When the choice was made by the same appropriate authority that the American public prefers competition to monopoly, and the courts confirmed that preference, such redistribution was no longer possible, at least not to the same degree.

The problem then, is to determine at what point equilibrium in pricing of the telecommunications service commodity can be achieved so that no one class of subscribers, business or residential, private or public, falls off the network because that particular class finds the pricing structure unaffordable.

THE CONTEL POSITION ON THE ACCESS CHARGE AND FEDERAL LEGISLATION

Contel supports initiation of the "access" charge order of the FCC, as modified.

Contel does not agree with the end result of the access charge order which would require the end-user to assume substantially all of the cost burden of the local loop.

Contel will continue to strive to reach a reasonable balance between the desire for universal service and the economic realities of a competitive telecommunications industry.

Contel stands with those who also believe it is in the overall good of the many different publics and suppliers of telecommunications that the access charge go into effect on January 1, 1984, the scheduled date.

Contel is opposed to any legislative solution which will delay or overturn that decision in its essentiality.

Contel would consider legislative initiatives which would (a) rationally replace the indiscriminate subsidization of all residential customers with a targeted subsidization of those who socially and economically merit such support (although we believe that the latest FCC decision—to grant waivers from its mandatory end-user charges when "lifeline" rates, determined by state commissioners are to be awarded—is probably an appropriate approach); (b) resolve the endless disputes between federal and state jurisdiction; (c) establish federal preemption over depreciation rates and methodology, and capital recovery.

A QUESTION AND ANSWER SERIES ON ACCESS CHARGES AND FEDERAL LEGISLATION

The questions below must be asked and answered if rational decisions on legislation are to be made. We trust that you, the industry representative, and our legislative representatives will have a fruitful exchange.

Question 1. Do the interest groups who are pressing for quick action really agree on a workable alternative to the impending FCC "access charge" order?

Answer. Not at all. The bills that have been introduced deal with a number of telecommunications topics including changing the FCC decisions on access charges and on the subsidy of local rates by long distance rates. Some include prohibitions on private systems or impose fees for these systems. Some expand existing subsidies or spread the costs of these universal service subsidies to competitive companies and private networks. Some change the existing division of authority or jurisdictional balance between federal and state regulators. Lastly, some simply expand regulation or preserve it in an increasingly competitive world. From Contel's perspective, all of the proposed bills have fatal flaws.

The responsible agency made its decision after hearing from all interested parties. The great majority of interested parties oppose overturning or delaying the FCC solutions, while the small rural companies and state commissioners propose restoring the status quo by legislation. Understandably, many consumer advocates oppose rate increases for any reason.

Question 2. Are you familiar with the mechanism designed to provide rate assistance to high cost rural and urban areas?

Answer. The Federal/State Joint Board has established a Universal Service Fund to which toll carriers and other types of carriers accessing the local network will contribute. This Universal Service Fund will reimburse residential ratepayers (by keeping their rates down) when the costs of owning and operating local exchanges exceeds 115 percent of the national average cost. People using the Message Toll System for toll calls will also experience a reduced toll bill (minimum 15 percent).

Question 3. Or the ceiling above which local rates cannot rise?

Answer. Ceilings will rise or fall based on the national cost average for local exchanges; still, the mechanism described above will automatically function.

Question 4. Do you want to subsidize affluent subscribers in high cost exchanges or send money from needy areas of the country to areas that are economically prosperous?

Answer. Whenever a low cost (in terms of plant investment) local exchange carrier contributes to a "pool" which will redistribute its assets to subsidize a company where costs are on the high side of a national average, there will be a net outflow from the low cost to the high cost company. This flow is from all subscribers to all subscribers. Thus, for example, telephone companies in New York State which have low plant cost will have an outflow on a pooled or aggregate basis to high cost rural companies in Arizona whose costs are high because of lesser subscriber density and much greater construction distances. Even under the present separations and settlements system, the economically disadvantaged in low cost companies may well subsidize economically better off subscribers in high cost areas. Perhaps there should be a differentiation between helping the needy and the indiscriminate subsidization of all subscribers?

The FCC has made a provision that will consider waiving the end-user access charge in those cases where states have prescribed "lifeline" charges for the truly needy. This provision may help resolve this situation.

Question 5. What percentage of the local increases being widely requested is likely to be approved by the state commissions?

Answer. The individual states review all utility rate requests in light of many factors—cost of money, demand patterns, operating costs, inflation, depreciation, construction, etc. Their judgments on allowable increases vary widely. As a generality, few utilities get what they request even though warranted.

Question 6. What portion of those rate proposals actually relates to the FCC proposed access charge and residential local rates of the future?

Answer. This is the most misunderstood part of the whole legislative thrust—that current increases can be prevented by upsetting the FCC access charge. These two are not related.

The access charge:

1. is not yet in effect;

2. should not influence current rate cases, including Contel's, which are based on present needs and estimates, not what happens after 1/1/84. They reflect loss of toll revenue, depreciation, inflation, changes in CPE activities, etc.

3. should not in itself generate rate actions. It assigns both end-users and carriers certain prescibed charges which are part of a total established interstate revenue requirement.

NOTE.—It is true that there will be end-user flat rate charges when the access charge comes into effect. These will increase existing flat rate local charges by a maximum of $2 per month for residential customers and $6 per month for business customers in 1984. It is true that these flat rate charges to the end-user will further increase over time. It could be true that the States will also add a portion of intrastate costs to the end user. The total increase will be noticeable, even considerable. Will the total end-user charge for local service be too costly for some subscribers? Of course, any product can be too costly if one cannot afford it. The bulk of residential subscribers, particularly those who now pay flat rates of $4–$10 per month for one party service may find this commodity affordable, even with initial access charge increments.

Question 7. Won't legislation that pushes the prices of services away from their true costs invite customers whose service costs are overburdened by subsidies to seek alternatives to the established network?

Answer. The same rationale as was used for increasing flat rate charges for residential and business exchange customers can be applied to toll users and toll carriers. If they are burdened with above true cost charges (i.e., subsidies), then they, aided by multiplying new technologies, may avoid using the local carriers' facilities by establishing their own private network, or they may make fewer toll calls. In eny event, the remaining toll customers and local rate payers will be forced to pay even higher rates to make up for these defections. The several proposals to tax or fine bypassers would prove counter-productive. Even if these proposals are constitutional, they are well-nigh unenforceable. What must be found is an equilibrium (and no one really knows where that point is)—a balance between economically unacceptable costs of local exhange service, and the unacceptable burden of subsidies. That balance lies at the point where no category of users will drop off the network in significant numbers.

Any legislation (or regulation) that does not reasonably meet these criteria should not be supported. No part of this industry or its users function independently. Thus, no one interest can be satisfied at the cost of another.

Question 8. Do you understand the term "uneconomic bypass" and its impact on the network upon which everyone depends?

Answer. Uneconomic bypass is really what we described above. Bypass becomes uneconomic when other systems are constructed only because the existing pricing structure has become so unbalanced that such action is economically attractive (less costly). As a matter of fact, this is already happening. Under pure market driven economics, this presumably would not happen. However, because this is not a pure market driven industry, a balance must be struck so that all customers share the burden between social requirements and economic theory.

Question 9. Do you recognize that trying to discourage all private networks could impair American competitiveness?

Answer. The discouragement of private networks will impair internal and external competition (given that the thrust towards a competitive environment is irreversible). If we encourage a single network to be so economically and technically

attractive that no private initiative will appear, we return to monopoly. Monopoly however, is no longer sustainable in our industry.

Question 10. What will be the cost of reversing the orderly process of industry change now underway?

Answer. Is it really possible to keep the present system in place even under a moratorium? Can the Bell System, poised on the brink of divestitute, regroup to do all the things that the continuation of separations and settlements require even on an interim basis? Can the Modified Final Judgment, with its LATAs, redistribution of assets, personnel transfer, revised contractual arrangements, new AT&T and BOC relationships be arbitrarily stopped or radically modified in a vacuum of workable ideas or solutions? The cost of a moratorium or years long reconsideration of the valid, albeit not perfect, solution by the courts and the Commission would be incalculable. Who will pay for the disruption? Is it not better to allow the entire process to continue, and to accept that the FCC's monitoring arrangements are sufficient to arrest destabilizing trends than it is to resurrect the 15-year debate which polarized the industry?

Question 11. Who will pay for the costs of changing to a different alternative at this point?

Answer. If the access charge is overturned, which may well involve reconsideration of the Modified Final Judgment, the carriers will not know where they might turn for reimbursement. The costs of such regressive action and the massive attendant chaos are incalculable.

Question 12. Will the proposed "universal service" legislation prove to be a short term "fix" that will eventually increase rates for residential telephone users?

Answer. We previously discussed this. Reimposing all interstate non-traffic sensitive costs on carriers is an invitation to uneconomic bypass, which means that someone other than the bypassers has to meet the revenue requirement, which remains unchanged.

Question 13. Will not arbitrary increases in long distance rates harm many of those persons whom the sponsors of legislation are seeking to help?

Answer. Of course. It is true that some people make few long distance calls. It is rare that customers neither receive nor make long distance calls. Increasing telephone costs through subsidy loading will have a repressive action on toll users. As much as we local exchange carriers would like to see our customers protected, we do not live alone in this world. If toll call costs are over-burdened, the toll carriers will someday suffer and their services will deteriorate. Is that to anyone's advantage? The key word is balance.

Question 14. Are you aware that there will be an ongoing program to closely watch any impact on universal service, and that the FCC will readily make any change that becomes necessary to maintain that service?

Answer. From Contel's viewpoint, this is the single most important aspect of the FCC access charge order. There is indeed a workable system proposed that can adjust the access charge situation. The FCC's monitoring system, open and, we hope, responsive, is very flexible and reactive. Legislative solutions to yet unknown problems would bring unacceptable, if not dangerous, rigidity to a transitional process that requires delicacy and understanding of the processes.

CONCLUSION

Contel believes that true equilibrium is still to be attained. We are pleased that our efforts did, at least, help persuade the FCC that the original Pure II concept they appeared to favor could be sheer disaster. The access charge, in its initial years of transition, is a far cry from Pure II. High cost factors, universal service funds, new charges on accessing carriers and a promising control system are marked improvements.

We do not want to discourage Congressional interest. We encourage oversight, not overturn.

STATEMENT OF MELVYN J. GOODMAN, PRESIDENT, COMBINED NETWORK, INC.

I am Mel Goodman, President of Combined Network, Inc. My company is the nation's third largest provider of alternative long distance telephone service other than AT&T. I am pleased to have this opportunity to discuss the Universal Telephone Service Preservation Act of 1983—and to announce that we will soon be operating in Seattle, bringing new jobs and low cost long distance telephone calls to consumers.

Our company fully supports the preservation of Universal Telephone Service. In other words, we share the concerns of Congress for the need to maintain local telephone service at reasonable and affordable rates. This objective can be achieved by an appropriate system of charges for exchange access which will alleviate a significant portion of the upward pressure on local telephone rates while, at the same time, will solve a problem of critical importance to long-distance telecommunications companies which compete with AT&T.

Approximately 400 companies compete in providing long-distance telecommunications service. This competiton has been a direct result of FCC and court decisions establishing a clear public policy in favor of increased competition in long-distance telecommunications. The resulting growth of competition has produced, among other things, greater efficiencies thereby lowering long-distance telephone charges to the consumer.

Notwithstanding the beneficial competition which characterizes the long-distance telecommunications industry, local exchange facilities remain monopolies. Thus, without access to the local exchange facilities controlled by these monopolies, no competitive long-distance telephone company could survive.

Currently, the long-distance competitors of AT&T pay for access to local exchanges under an arrangement known as "Exchange Network Facilities for Interstate Access" (ENFIA). AT&T, on the other hand, pays for access by dividing revenues with its local operating subsidiaries pursuant to a procedure known as Division of Revenues. By means of the access payments by all carriers, long-distance telephone revenues have historically contributed to the revenue requirements of local exchanges, helping to control local telephone rates. Of course, with a 96 percent share of the long-distance telephone market, the bulk of these payments comes from AT&T. And, to a substantial extent, it is unsubstantiated fear of the potential loss of this revenue that has precipitated the recent spate of unprecedented, and largely unjustified, local rate increase filings by numerous local operating companies.

A word should be said at this point about such rate increases. Contrary to statements made by AT&T, these increases are unrelated to competition, the actions of the FCC, or divestiture. If anything, those events will decrease rates. AT&T has seized upon an opportunity to increase revenues. AT&T cannot substantiate any claims that these increases are the result of a competitive environment.

In any event, by assuring a continuation of the present system of access charges, S. 1660 will alleviate much of the need for new local revenues and provide a basis for state utility commissions to reject these unwarranted massive rate increase filings.

Under ENFIA, there is a difference between the amount "paid" by AT&T for access to the local exchange carriers and the amount paid by competing long-distance competitors of AT&T because the type of access AT&T receives is far superior to that provided competing long-distance companies. For instance, telephone users wishing to place a long-distance call over AT&T's system need dial only 10 or 11 digits whereas customers of AT&T's competitiors must dial as many as 24 digits. Unlike AT&T's competitors, AT&T can also serve customers with rotary-dial phones. Additionally, AT&T receives superior billing information to that provided AT&T's competitors, including identification of the calling customer's telephone number and confirmation of the successful completion of a long-distance call. In short, the higher access charges paid by AT&T simply reflect the superior quality of the interconnection provided AT&T.

Much has been said about the need for AT&T and other long distance telephone companies to compete on a "level playing field." I do not object to this principle, but Congress must recognize the advantage AT&T currently enjoys. Consequently, we should be sure we're all playing the same game from an equal start when we're placed on that "level playing field."

So long as equivalent access to the local exchange remains unavailable to the long-distance competitors of AT&T, the existing differential in access charges cannot be eliminated without undermining the viability of competition in long-distance telecommunications services.

S. 1660 largely incorporates this principle. However, a deficiency of the Senate bill, shared by the House bill, is the absence of an assurance that equivalent access through equivalent means of interconnection will in fact be provided to competing interexchange carriers as equal exchange access charges are substituted for the current system. While I am optimistic that equivalent means of interconnection will ultimately be provided by local operating companies following divestiture, prudence dictates that we recognize the potential for delays in attaining his objective as well as the lengthy time period by which the local operating companies are allowed to

actually provide equal access. Otherwise, interexchange carriers who compete with AT&T in providing long-distance telecommunications services will be placed at a severe competitive disadvantage if the existing differential in access charges is prematurely eliminated.

Congress can avoid this result by attaching the differential for interconnection to the provision of equal interconnection in each exchange area as determined by the FCC. Stated differently, under this proposal the differential would remain in effect for each exchange area until that area, as determined by the FCC, is provided with equal access.

By proceeding cautiously through a gradual substitution of a new system of access charges, a more orderly transition to a post-divestiture communications industry will be assured. I seriously doubt whether the consumer will be able to enjoy alternative, less expensive, long distance rates unless Congress takes steps to ensure a strong competitive environment by recognizing an appropriate price differential until equal access is available.

I look forward to working with you on this legislation.

OREGON INDEPENDENT TELEPHONE ASSOCIATION,
Salem, Oreg., September 2, 1983.

Senator SLADE GORTON,
Federal Building, Second Avenue, Seattle, Wash.

DEAR SENATOR GORTON: The Oregon Independent Telephone Association Board of Directors has voted to support legislative efforts currently underway. We were unable to be on your hearing agenda August 29, 1983. Please take this as our official testimony and treat it as such.

Please recognize that there are diverse interests and opinions within the industry on these issues. OITA is no different than others in this respect and our vote was 10–2 in favor of legislation with 3 Board members absent. At a recent member meeting, 27 of our 30 companies were represented; only 3 voted against supporting legislation.

In Oregon we have about 30% of the customers to Bell's 70 percent, but cover 50 percent of the geography. We are typical of western states, as is your state, Washington, with the distinctly rural serving area. Other than Portland, Eugene and Salem, we have little to offer the resellers. Inroads of competition may bring savings in equipment and toll rates, but customers in rural areas do not generate enough activity to have alternate less expensive rates. Customers calling from 10, 20, even 40 miles out of these major cities will likely see an increase in short haul long distance rates, as well as the projected local rate increases.

We serve many small businesses, ranches and farms. These customers also face the prospect of higher local and long distance rates. Recently, one company spent $375,000 to serve about 50 customers with over 50 miles of cable. Without the long distance subsidies, this will not happen in the future.

Many of our companies feel this whole issue is a matter of universal service at reasonable rates versus benefits for big business. Our customers object to the access charge. One company recently determined that 12 percent of their customers do not make long distance calls. Many low income people are on the threshold of removing service as costs increase from other FCC decisions.

The proposed rates we see from studies done recently by our association in conjunction with Pacific Northwest Bell and our PUC, may mean that many customers give up their service.

We agree with the idea that long distance providers and customers who bypass the network should be assessed charges to maintain universal service. Changes in depreciation, expense procedures and other FCC rulings are already causing increased pressures on local rates.

Since the state regulators will probably mirror the FCC access charges, there could be even higher rates than currently contemplated. The $2 to $6 recently talked about only speak to FCC charges in 1984. There will also be a state charge, probably of $2. However, even more important is that this is just the beginning. To look at it realistically, think of the end result in 1989. Just the FCC imposed access charge will be $8–$10.

Attached is a document just released by our public utility commission staff. The last page shows the results of a study showing the effect on rates of FCC decisions. OITA, Pacific Northwest Bell and the PUC participated in this study.

We need legislation that:

(1) Will do away with access charges.

(2) Require all carriers to pay their fair share of the cost of inter-exchange access and some support for a universal service fund.

(3) Require those who by-pass to pay a rate equal to other inter-exchange carriers and support to the universal service fund.

(4) Provide for appropriate depreciation rates, so we may keep up with new technology.

We are not looking for delays of the FCC decision. We want a better way of solving the problem. We believe the concepts in S. 1660 and H.R. 3621 are heading in the right direction. We urge passage of such legislation, and would willingly help in any way we can to see it happen.

Very truly yours,

MAURICE ASTLEY,
Executive Vice President.

Enclosure.

ESTIMATING ONE-PARTY RESIDENTIAL TELEPHONE RATES RESULTING FROM RECENT FEDERAL COMMUNICATIONS COMMISSION DECISIONS (DOCKET 78–72) AND FEDERAL COURT ORDERS

Considerable interest has been expressed by residential consumers in knowing the possible financial impact of two major federal actions: (1) A court order that breaks up the existing American Telephone & Telegraph Co.'s Bell telephone network, and (2) decisions by the Federal Communications Commission (FCC) to improve the ability of other companies to compete with AT&T for long-distance toll business.

It is impossible at this time to accurately forecast the future cost of telephone service for any class of customers because so much is still unknown. For example, the FCC recently modified its own order in its Docket 78–72, and only an educated guess can be made as to the result of that modification. The Public Utility Commissioner's staff has developed rough estimates of future costs for one-party residential customers, but the only data on the FCC's modification of its order that was available to staff at the time the following estimates were made was a brief press release describing the decision. The staff will not be able to complete an analysis of the decision itself until mid-September.

The estimates given on the attached table represent average charges. They include modest amounts of inflation and growth in toll minutes of use. The estimates are based in part on revised data presented to the PUC staff by the telephone industry, but at this time none of the companies is able to present a wholly complete estimate of 1984 costs. In some cases the data is incomplete, as noted.

There are many other significant unknowns:

1. The FCC has yet to ratify or change the decision of the federally chartered Joint Board on Telecommunications with respect to allocation of revenues from a "Universal Service Fund" created to hold down rate increases of telephone companies with extraordinarily high costs.

2. Some smaller telephone companies do not calculate all of their system costs because of the complexity and expense of doing so. These are termed "average cost companies," and they are thus required by the FCC to become members of an Exchange Carrier Association (ECA). The ECA will file tariffs with individual regulatory bodies for the average cost companies. The ECA will not be able to file these tariffs until sometime in October. Exact ECA tariffs are necessary for the staff to make accurate forecasts. In the interim, the PUC staff, in estimating future residential rates, relied on the Joint Board's recommendations to the FCC.

3. Agreements among the telephone companies on how to share long-distance revenues are roughly known for the year 1984 only. The computations that follow are based on the assumption, correct or not, that the agreement for 1984 will be used in subsequent years.

4. It will not be known for many months whether there will be a shift from Pacific Northwest Bell to other long-distance carriers in intra-LATA toll traffic. A significant shift would cause an upward revision in the estimate of PNB's future rates.

5. It is not known whether future changes in long-distance rates will increase, reduce or have no effect on revenues from toll calling.

6. It is not known whether upward pressure on local telephone rates resulting from the federal decisions will cause a major reduction in the number of families who feel they are able to afford telephone service.

7. It is not known whether or to what extent the telephone industry will be further regulated, or to what extent new competition within the industry may have on rates, if any.

8. It is not known whether Congress will adopt any of the many pending bills that propose to revise the FCC's decision.

Nevertheless, because of the interest developing, the Public Utility Commissioner has directed preparation of a table showing an estimate of future rates for one-party residential service. The table attached must be regarded as very preliminary because of the lack of factual information as described above. It should be noted that the estimates given in the table are different from the estimates provided by the Public Utility Commissioner in his testimony on August 8, 1983, to the U.S. House Energy and Commerce Telecommunications Subcommittee. Since that testimony was prepared, the FCC modified its decision in Docket 78–72; the earlier estimates did not include the estimated costs associated with provision of Extended Area Service (EAS), which is now provided, for example, to more than half of Pacific Northwest Bell's customers. Nor did they include the costs associated with switches and other facilities installed by companies to enable local calls to be made. The figures given by the commissioner were intended as estimates of only the basic cost of giving residential customers a dial tone.

Readers of this paper are cautioned again that the estimates of future local telephone rates given on the following page are based on incomplete data, and may be subject to substantial revision over the next few months.

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